CONGRESSIONAL DIGEST

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THE PRO AND CON MONTHLY

December, 1931

Congress and the Banking Situation

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Federal Bank Supervision Described
Why Banks are Failing Today
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The Pro and Con Monthly

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The CONGRESSIONAL DIGEST

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Politics

1. *The science and art of government; the science dealing with the organization, regulation, and administration of a State, in both its internal and external affairs; political science; also, formerly, that branch of ethics dealing with the ethical relations and duties of states or social organizations.*

2. *The theory or practice of managing or directing the affairs of public policy or of political parties; hence, political affairs, principles, convictions, opinions, sympathies, or the like; in a bad sense, artful, or dishonest management to secure the success of political candidates or parties.—Webster's New International Dictionary.*

Democrats Claim House on Eve of New Congress

by N. T. N. Robinson

TWO weeks before the date of the assembling of the Seventy-second Congress, the question of whether the Republicans or the Democrats will organize the House is still in doubt. On the face of the returns the Democrats have a majority of two over all. Three vacancies are still to be filled; all three caused by the passing of Republican members.

In two of these districts—one in New Jersey and one in Texas—special elections will be held in time for the successful candidate to be sworn in and vote in the House organization ballotting. In the third, a New Hampshire district, a special election will be held January 5, by which time, in the absence of a long deadlock, the House will have been organized.

So far as the New Jersey and Texas vacancies are concerned, the Republicans hope to carry the former, and claim a fighting chance in the Texas district. The Democrats are counting on sure victory in Texas and are making every effort to carry the New Jersey district.

Whatever happens the division in the House is expected to be closer than it has ever been in history.

Counting on organizing the House, the Democratic leaders are at work on their plans. The question of the Speakership will not bother them as Representative John Garner of Texas is the only candidate and will receive, apparently, the solid support of his party associates. He will undoubtedly be nominated and he and his close friends are looking forward confidently to his election over the Republican candidate.

It is with the other offices in the House organization that the Democrats are having trouble, particularly with committee chairmanships and assignments. By long custom in the House and Senate committee chairmanships are bestowed according to seniority in service on the committee. It so happens that under this rule the vast majority of the important committee chairmanships will go to Southern Democrats if their party organizes the House.

There has been some talk of breaking this rule by agreement and having a number of Southerners who are prospective committee chairmen under the seniority rule to step aside and permit Northerners to have a large share of chairmanships. This plan, however, has apparently fallen through for the simple reason that the Southerners are refusing to give up what they are slated to get under the seniority rule.

What trading will be done, therefore, to give representation to the Northern Democrats will involve other offices in the House organization, including the floor leadership, the clerkship and other minor offices.

For some weeks there has been talk among what few Congressmen there were in Washington of giving the floor leadership to Representative John J. O'Connor, of New York, a Tammany Congressman. As the number of Congressmen in Washington increases, however, it becomes apparent that there will be strong opposition to Mr. O'Connor on two grounds. One is that Tammany Hall is now being investigated in New York and that the general unpopularity of Tammany throughout the rest of the country makes it inadvisable for the Democratic organization of the House to put a Tammany man in a conspicuous position on the eve of a Presidential election. The second reason is that Mr. O'Connor is an ardent and active "wet", while a majority of the Democratic members of the House are dry. It is even believed that the leaders of Tammany Hall are none too anxious to support Mr. O'Connor.

Representative John McDuffie of Alabama, as Democratic whip, would be in line for the floor leadership and undoubtedly would get it but for the fact that Speakership and most of the important committee chairmanships will go to Southerners.

What appears to be in the cards at this writing is that a compromise will be effected and that the floor leadership will go to the Middle West, most probably to Representative Henry T. Rainey, of Illinois.

The Republicans also have a few troubles ahead of them, in case they are able to organize the House. At their caucus they will have to nominate a candidate for

the Speakership and there is a hot contest on. The leading candidates are Representative Bertram Snell of New York, for several years chairman of the House Committee on Rules, and Representative John Q. Tilson of Connecticut, Republican floor leader. There have been predictions that perhaps there would be a compromise candidate from the Middle West, but so far the battle appears to be between Snell and Tilson.

The Progressive Republicans in the House will undoubtedly make demands upon the regular Republicans for certain concessions in the House rules as the price of their support for the Republican candidates for the House offices. Under the present rules a bill may be held in committee subject, more or less, to the will of the committee chairman. The House may vote to discharge a committee from consideration of a bill but it is difficult to get a majority of the House for that purpose.

The Progressives want the rules changed so that when 100 members of the House sign a petition to bring a bill in from committee, the bill will be ordered in. They also want to have committee meetings called on a majority vote of the members of the committee, with or without the consent of the chairman. It is probable that some concessions will be made along these lines.

As to legislation, Democratic leaders now in Washington admit frankly that nothing can be accomplished without some sort of working agreement with the President. The margin will be so close in the House that even if a Democratic program is put through and succeeds in getting by the Senate it will have to face a Presidential veto. The closeness of the division in both Houses will make it almost impossible to pass anything over a veto. Knowing this, the Democrats are preparing to shape their course accordingly in the event of gaining control of the House.

While it is still too early to forecast what the major legislative problems will be there are certain outstanding matters that must be given consideration. The Democrats are frank to say that tariff revision is necessary, in their opinion, and are determined to make an effort in that direction. In this they probably will have the support of the Progressive Republicans. Whether they will attempt revision all along the line or revision on individual schedules has not been decided. It seems probable that individual, or "popgun" bills will be presented by the Democrats.

The Treasury deficit calls for the imposition of new taxes. What form they will take is also problematical. The Administration will advance a plan and the Democrats will advance a plan, with the chances being that a compromise will be effected. Farm relief will be considered with the debenture plan and the equalization fee plan both being advanced. Unemployment relief and unemployment insurance will be pressed, but what will happen to them is problematical. Banking legislation; Philippine independence; soldier bonus and reapportionment are sure of serious consideration.

The first big business will be the consideration of the Hoover Moratorium on German Reparations and Foreign Debts. This will be brought forward promptly and will precipitate a bitter fight. The opposition has been aroused because of the apprehension that the Hoover plan will lead to debt cancellation and in both the house and the Senate there will be serious debate on the subject.

Ordinarily the discussion of the foreign policies of the United States is confined principally to the Senate on account of its treaty ratifying powers, but the House will have to pass upon the moratorium plan as well as the Senate. The reason for this is that the question of revenue raising is involved. The money the United States Government loaned to the foreign Governments was raised by the selling of bonds and by taxation and hence the House must act.

The coming session will be full of politics; with moves and counter moves designed to have an effect on the Presidential election of 1932. To observers of politics it will furnish an interesting study. Its effect on the general public will be watched with keen interest.

What may be a spectacular political battle or what may be a dull and innocuous anti-climax, will occur in the Senate of the United States soon after the 72nd Congress convenes on December 7. This drama will be performed on the day the Senate elects its officers. This will not be on the first day of the session, since it is customary on the first day for both branches of Congress to meet, appoint a committee to notify the President that Congress is in session and ready to hear from him and then adjourn.

But within a day or two, after both political parties have met and selected their candidates for the various offices, the Senate proceeds formally to organize and elect its officers for the term of the Congress.

The highest office in the gift of the Senate is that of President Pro Tempore. The Vice President of the United States is the regular President of the Senate, but a President Pro Tempore is always elected by the majority to serve during the Vice President's absence.

Senator George H. Moses, of New Hampshire, has held that office for several terms. Some time ago in an outburst against the Progressive or Insurgent Republicans of the Senate, after they had joined with the Democrats in defeating the Regular Republicans on a vote in the Senate, Senator Moses referred to the insurgents as "sons of the wild jackass." The insurgents have never forgiven Senator Moses for this and before Congress adjourned last March they let it be known that they would endeavor to prevent his reelection as President Pro Tempore.

To accomplish this they will oppose him in the Republican Conference, if they attend it, and failing there, as they probably will, they will on the basis of their threats, either vote for the Democratic nominee for President Pro Tempore on the floor of the Senate, or have a few of their group absent themselves from the Chamber and thus throw the election to the Democratic candidate.

A few weeks ago Senator Moses hinted that in such an event he would vote with the Democrats on the election of committee chairman, thus throwing the entire control of the committees into the hands of the Democrats.

Should Senator Moses do this, all the committee chairmanships would go to the Democrats. This would mean that nine prominent Progressives would lose chairmanships. If, in the face of the Moses threat, the Progressives carry out their original threat a spectacular fight will be precipitated. If the Progressives and Senator Moses bury the hatchet, the Republicans will retain control of the Senate by a narrow margin. Opinion in Washington is divided as to the probabilities. The majority view, however, is that the Progressives will not risk the loss of their committee chairmanships in order to punish Senator Moses.

Congress and the Banking Situation

Foreword

NO problem looms bigger in American affairs today than the problem of banking. Legislation on banking is sure to receive consideration during the coming session of Congress since such legislation will be a vital part of any constructive plan looking to the establishment of economic stability as well as early economic relief.

Long before the fall in stock market prices in the autumn of 1929 it had become apparent that the banking system needed improvement. The large number of bank failures during the few years preceding caused not only Government officials but bankers and business men as well to give serious consideration to the American banking structure as a whole in an endeavor to arrive at some plan to remedy the situation.

The advent of the world-wide economic depression was naturally reflected in the banking situation with the result that its ailments were aggravated. This gave impetus to discussion of banking affairs on the part of Administration officials and Members of Congress with the result that resolutions were passed in both the House and the Senate directing committee investigations on the general banking situation.

In the meantime various bills were introduced to put large sums of money in the hands of the different Government financial agencies to be used in aiding the banks. The committees of the Senate and House, particularly the latter, were, however, working toward a long-range plan of legislation rather than an emergency plan, and none of these bills for the immediate distribution of money was seriously considered.

To meet the emergency and to restore confidence President Hoover, early in October, formally announced a program of action to be pursued by the Administration. The first step was to be taken by the leading bankers of the country, independent of the Government, by the organization of a bankers' pool to be used to extend credit to small banks. This resulted in the prompt creation of the National Credit Corporation.

The remainder of the President's program will require legislative action by Congress since it involves increased funds for the Farm Loan Board to be used for agricultural loans through the Federal Land Banks and for a new group of banks proposed by the President for the handling of home building and certain classes of urban real estate loans, and also involves, possibly, the creation of a governmental finance corporation similar to the War Finance Corporation and the extension of the list of securities upon which the Federal Reserve Board is permitted to rediscount the notes of member banks.

In presenting the banking problem the CONGRESSIONAL DIGEST has sought to consider primarily the layman. Discussions of banking problems are usually filled with technical terms, simple to the banker, but practically unintelligible to the layman. To assist the layman in understanding the banking terms currently in use, a glossary is printed on page 306 of this issue.

Primarily the average citizen is interested in whether a bank is sound. As pointed out by President Hoover in his statement announcing his program, the confidence of the public in the soundness of American financial institutions must be restored. The reasons for the great number of bank failures in recent years are clearly set forth in the article by John W. Pole, Comptroller of the Currency, beginning on page 297.

Following a brief history of banking legislation in the United States, on page 293 the reader will find described all the Federal agencies which have to do with banking.

In setting forth his plans for financial stability the President makes frequent reference to these various agencies and they are continually referred to in the Pro and Con discussions.

What the last Congress did regarding banking legislation is set forth in an article by Charles S. Cobbins, former Deputy Comptroller of the Currency and a recognized authority on banking, on page 304.

Representative Louis T. McFadden, of Pennsylvania, Chairman of the House Committee on Banking and Currency, during the past Congress, gives, on page 305 an outline of those phases of the banking problem most likely to be considered in the coming session.

Finally, in the Pro and Con section, will be found discussions of two phases of the banking problem uppermost in the thought of those engaged in an effort to solve it. These two questions are whether an extension of the branch banking system would be beneficial and whether the law governing the types of securities which the Federal Reserve System is permitted to accept for discount purposes, should be amended so as to permit the acceptance of other types of securities.

Other phases of the banking problem are up for discussion, but they are more or less technical and rather remote from the interests of the average citizen.

In following the discussions of banking in Congress during the coming session, the student should distinguish between measures designed to meet emergency needs and those designed to improve permanently the entire banking structure of the country.

Among the emergency plans are the National Credit Corporation, suggested by President Hoover and promptly brought into existence by the Clearing House Associations; additional funds for the Farm Loan Board and the revival of a government finance corporation along the lines of the War Finance Corporation.

The suggestion for permanent improvement involve branch banking extension; the liberalizing of the Federal Reserve Act and a closer control of banks by Federal Government.

Highlights in History of American Banking Legislation

by Dr. E. A. Goldenweiser

TWO central banking institutions of large resources were established in the early period of our history under acts of Congress granting to them exclusive banking privileges, and although each of these institutions fulfilled the purposes of its incorporation in providing a uniform, safe currency and in rendering services as the fiscal agent of the Government, each failed nevertheless to secure from Congress a renewal of its charter.

The act incorporating the First United States Bank, drawn in accordance with a plan submitted by Hamilton, became a law on February 25, 1791. Incorporated for a period of 20 years, with an authorized capital of $10,000,000, the bank appears to have been well managed from first to last. It had authority to loan on real estate, to issue bills and notes receivable in payment of all debts to the United States, and to establish branches for discount and deposit anywhere in the discretion of its directors. Its charter expired on March 4, 1811, and was not renewed.

For several years following, including the war period, public receipts were deposited in selected State banks. The note circulation of these depositories and of State banks generally increased rapidly in the war period. In 1814, Secretary Dallas recommended establishment of a national institution as "the only efficient remedy for the disordered condition of our circulating medium." The act incorporating the Second Bank of the United States, with a capital of $35,000,000, was signed by President Madison on April 10, 1816, and the bank began operations on January 7 of the year following at what is described as the "worst stage of the monetary troubles" consequent upon the suspension of specie payments in 1814.

The charter provisions under which the first and second banks of the United States operated were essentially similar. In each case the Government subscribed for one-fifth of the capital, paying its subscription in Government stocks. Private subscriptions were payable one-fourth in specie and three-fourths in Government stock. The directors were authorized to establish branch offices; public receipts were to be deposited in the bank and its branches for transfer and disbursement; and bills and notes of the bank were receivable in payment of debts to the United States. The first bank established eight branches, and in 1829 the second bank was operating 25 branches.

President Jackson in his first message in 1829 raised the question of "both the constitutionality and the expediency of the law creating this bank," and in 1832 he vetoed a rechartering bill. The question of rechartering immediately became the dominant issue of the following campaign, and Jackson's reelection was interpreted as a popular endorsement of his bank policy. In September, 1833, Secretary Taney issued an order for effecting a removal of public deposits to selected State banks, and this executive procedure was given legislative endorsement in an act of June 23, 1836, specifically providing for deposit of public moneys in State banks. At the expiration of its national charter, the Bank of the United States continued to operate for some years under a charter obtained from the Legislature of Pennsylvania.

Difficulties similar to those experienced in the earlier period in which public funds had been entrusted to selected State banks were now again experienced by the Treasury. The State banks had greatly expanded their note circulations and were heavily involved in public land speculations. The collapse came in 1837, and in May of that year banks in all sections of the country suspended specie payments.

Banking in the years between 1846 and 1863, when the national system was initiated was under the laws of the several States.

Distinguishing features of the national banking system, as set up in the acts of 1863 and 1864, are found in the provisions for national incorporation of banks and for the issue of a bond-secured bank currency; in specific requirements as regards reserves to be held against deposit liabilities; and in provision for general supervision under direction of a Treasury official, the Comptroller of the Currency.

It was provided that banks taking out national charters should be permitted to issue notes secured by United States bonds deposited with the Secretary of the Treasury up to 100 per cent of the market value of the bonds not exceeding par. On March 2, 1865, an act was passed imposing a prohibitory tax of 10 per cent on State bank notes issued after July, 1866. This act by virtually restricting the note issue privilege to national banks was effective in inducing State banks to take out national charters, and the number of national banks increased from 638 in January, 1865, to 1,513, in the following October. Under the national banking system currency issues were safe but rigidly inelastic. After the panic of 1907 an act was passed authorizing banks to issue emergency notes secured by commercial paper and other securities, but the notes were subject to taxation at a rate sufficiently high to make them unprofitable except as temporary emergency issues.

The Federal Reserve Act of December, 1913, effected a thoroughgoing revision of our banking system. It required all national banks to become members of the Federal Reserve System on penalty of surrendering their national charters. State banks are permitted to join, retaining all their State charter privileges in so far as these are not inconsistent with the provisions of the Federal Reserve Act.—*Extracts, see 1, p. 320.*

Extent of Federal Supervision of Banking Today

I. The Comptroller of the Currency

Comptroller, J. W. Pole

WHEN the national banking system was established in 1864 the office of the Comptroller of the Currency was created in order that there might be a Federal official to supervise the new banking system. Although the name "Comptroller of the Currency" is now more or less of a misnomer, since his primary function is that of a bank supervisor, in the beginning the chief interest of the Federal Government was in the establishment and protection of the new system of currency created by the issuance of the national bank notes. In the title of the office, therefore, the currency feature predominates.

There are now in the Bureau of the Comptroller of the Currency, in addition to the Comptroller, three Deputy Comptrollers and a Chief National Bank Examiner with the necessary number of assistants and clerical personnel to perform the work of the Washington office. In addition there is a field force of one hunudred and forty-eight national bank examiners operating under twelve District Chief National Bank Examiner with headquarters in the respective Federal Reserve cities.

The principal functions of the Comptroller are to pass upon charters for new national banks, to supervise the operations of the going national banks, to appoint receivers and supervise the winding up of the affairs of failed national banks and to sit as a member of the Federal Reserve Board. The Comptroller is required to make an annual report directly to Congress.

Any group of persons, not less than five, may apply to the Comptroller for a charter to form a national bank. When such application is received the Comptroller orders an investigation to be made as to the character, experience and financial standing of each of the applicants and also into the question whether there is need for a new bank in the place requested and whether there are prospects of the bank operating with success. If these conditions are met a charter is issued and the bank begins operations under the general supervision of the Comptroller, who is required by law to have the bank thoroughly examined at least twice a year. In addition to the examination reports, which are made to the Comptroller and which are held in confidence, all national banks are required upon notice by him to report to him not less than three times a year a true condition of the bank at the close of a prior day named by the Comptroller.

In many instances persons desiring to organize a national bank do not meet all of the requirements of the Comptroller and the application is denied. The responsibility is largely upon the Comptroller to prevent undesirable national banks from being organized.

The most important work done by the Comptroller of the Currency is that involved in the regular examinations of national banks. It is the duty of the Comptroller to require every national bank to conform to the provisions of the national banking laws. These laws govern every phase of the banking business, the most vital of which are the making of loans and investments. At stated intervals unknown to the bank, a national bank examiner walks in and begins a thorough and comprehensive examination of all of the bank's affairs. He goes over the loans made by the bank and appraises all of the securities which the bank may have purchased. He makes a complete report in writing to the Comptroller which shows in detail whether the bank is operating in a safe and conservative manner. It is from these reports that the Comptroller gains the information upon which to deal with the bank. This contact through the examiners is the chief means of enabling the Federal Government to discharge its responsibilities to the public in the matter of national bank supervision. If a bank knowingly and willfully violates the national banking laws, the Comptroller of the Currency has authority to bring suit in his own name to forfeit the charter of the bank. However, within the entire period of the sixty-two years of operation of the national banking system it has been necessary for the Comptroller to resort to this procedure only two or three times.

When a national bank fails it is the duty of the Comptroller immediately to appoint a receiver. The receiver takes charge of the bank and winds up its affairs. He collects the debts due the bank and out of the proceeds, added to the cash on hand, he pays dividends to the creditors who are largely the depositors. It should be stated here that although the Federal Government attempts by supervision to keep all national banks in sound condition, it does not guarantee to the depositors that they will be paid in full in the event the bank fails.

Two forms of currency are issued from the office of the Comptroller of the Currency. The first are the national bank notes which any national bank may request upon depositing with the Treasurer of the United States a sufficient amount of Government bonds of the character permitted by law as security for these notes. The engraved plates are manufactured by the Government at the Bureau of Engraving and Printing at the bank's expense. The notes are shipped to the bank where they are signed by the president and cashier. The second class of currency issued by the Comptroller's office are the Federal Reserve notes and these form the bulk of the paper money now in circulation. These notes are manufactured by the Bureau of Engraving and Printing and are issued to the Federal Reserve Banks by the Comptroller upon proper requisition.—*Extracts, see 3, p. 320.*

II. The Federal Reserve System

Governor, Eugene Meyer

THE Federal Reserve Board is composed of the following members:

Ex-officio: Secretary of the U. S. Treasury, Andrew W. Mellon, *Chairman*

Comptroller of the Currency, J. W. Pole.

Gov.: Eugene Meyer. *Vice-Gov.* (vacant).

Charles S. Hamlin, Adolph C. Miller,

George R. James, W. W. Magee.

THE Federal Reserve System was established under the Federal Reserve Act of December 23, 1913, one of the most important pieces of financial legislation ever enacted in our country.

Prior to inauguration of the System, our country was visited from time to time by disastrous money panics (1907, 1893, etc.). Even in normal times difficulty was sometimes experienced in financing the movement of crops, etc. These crises focused attention to the weakness of the financial system and brought about remedial action.

In 1908 Congress appointed the National Monetary Commission to inquire into and recommend changes in the banking and currency laws. This commission made an exhaustive study not only of our own laws and experiences, but also those of the principal countries of Europe. It reported to Congress in 1912, and submitted a bill known as the Aldrich Plan. This bill failed of passage, but it paved the way for the Federal Reserve Act.

The purposes of the Act, as stated in its title, are to "provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." These provisions were designed to remedy defects in the financial system, and to increase its strength and efficiency.

One of the major defects of the old system was the lack of coordination in commercial banking. There were about 7,500 national banks, operating under Federal law, and over twice as many State banks and trust companies, subject to the laws of the various States. They were independent units, without efficient means of cooperation or concerted action, especially in times of stress.

Under the Federal Reserve Act, the United States was divided into twelve districts, in each of which was placed a Federal Reserve Bank. The Act enabled both national and State banks to cooperate through the reserve banks, and in turn placed the twelve reserve institutions under supervision of a Federal Reserve Board in Washington. This arrangement has provided coordination and leadership in banking activities. The Federal Reserve Banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco, with branches in other cities. They are mainly banks for banks of their districts, but their benefits accrue to all.

National banks are required to be members of the system, while State banks and trust companies may become members if they meet the requirements. The member banks possess about two-thirds of the entire banking resources of the country.

The Federal Reserve Act not only pooled the legal reserves of member banks in the Federal Reserve Banks, but it required the members to purchase stock in the reserve banks and provided for the latter to receive Government deposits, etc. It authorized the reserve institutions to use these funds (except 35% reserve against deposits) for credit purposes. The Act also permitted the reserve banks to augment their credit extending ability by issuing circulating notes. Moreover, it empowered the Federal Reserve Board to suspend temporarily, if it should ever become necessary, any reserve requirements of the Act. In this way, a flexible credit system was provided.

The Federal Reserve Banks are authorized to rediscount for member banks, obligations arising out of agricultural, industrial or commercial transactions, or to discount their promissory notes secured by United States bonds and notes, at the reserve banks' discount rates. Also, the Federal Reserve Board may permit or require one reserve bank to rediscount for another. In addition, the reserve institutions may purchase and sell, in the open market, acceptances, United States obligations, etc., and deal in or make loans on gold. Under certain conditions, they may maintain foreign accounts and agencies.

By these means, it is possible not only to assist member banks and to transfer credit from one district to another, but to influence credit conditions and gold movements.

Inelasticity of currency was another outstanding flaw of the old system. The Federal Reserve Act remedied this defect by authorizing the reserve banks to issue Federal Reserve notes against the eligible paper acquired and at least 40 per cent gold. Besides being so secured, these notes are obligations of the United States and a first lien on the assets of the issuing reserve bank. This furnished a currency partly secured by self-liquidating paper, and experience has demonstrated that it is elastic. It has supplied flexibility to the monetary system.

Under the old system, there was no nation-wide plan for collecting checks at par. Various arrangements were made to avoid or reduce the charges imposed by many banks for collecting out-of-town checks or paying checks on themselves when received from outside sources. As a result, items were routed circuitously, which delayed collections and tied up funds.

Each Federal Reserve Bank exercises clearing functions for its member and nonmember clearing banks, and the twelve reserve institutions maintain a Gold Settlement Fund in Washington, through which clearings between them are consummated daily over private wires. The law prohibits exchange charge against the reserve banks, and they handle, without charge, all checks which are collectible at par. As a rule, items are routed directly to the places of payment, which saves considerable time and keeps the float at a minimum.

Before establishment of the Federal Reserve System, a bank needing funds in another city purchased "exchange" from a dealer or asked its correspondent to make the transfer. The cost fluctuated with the supply and demand. It was often necessary to make heavy shipments of currency, which involved expense and hazard.

Now transfers of funds between member banks in a district are made through their reserve accounts at the Federal Reserve Bank. Transfers from one district to

another are affected through the Gold Settlement Fund in Washington, over the private wires. These transactions are consummated by book entries, at a great saving of time and money.

The banking powers of national banks were broadened by the Federal Reserve Act. It authorizes them, under certain conditions, to exercise fiduciary powers, to accept drafts or bills of exchange drawn on them, to make loans on farm land and other real estate, to act as insurance agents, to establish foreign branches, etc. The general funds of the United States were formerly kept in the Treasury, nine subtreasuries and numerous national banks. Besides being a difficult task to apportion the funds among these depositaries, the deposit or withdrawal of large sums often disturbed the money market.

Under provisions of the Act, the Federal Reserve Banks act as fiscal agents and depositaries of the United States Government, receiving and disbursing funds for its account. They absorbed most of the work of the subtreasuries, and the latter were abolished in 1921.

As required by the Act, after the necessary expenses and dividends are paid, the net profits of each Federal Reserve Bank are added to its surplus fund until the fund amounts to 100% of its subscribed capital. Thereafter, 10% of the net profits are added to the surplus each year, and the remainder is paid to the United States Government as a franchise tax. The amount paid to the Government is used to supplement the gold reserve against United States notes (greenbacks), or to reduce the Government's bonded indebtedness, in the discretion of the Secretary of the U. S. Treasury.

Each Federal Reserve Bank is governed by a board of nine directors. Three, designated Class A, represent banks or the lenders of money; three, termed Class B, represent agriculture, commerce or industry, or the borrowers of money; and three, known as Class C directors, represents the Government or the public. They serve for terms of three years each. The directors of the first two classes are elected by the member banks and the third group is appointed by the Federal Reserve Board. It designates one of the Class C directors as Chairman of the Board and Federal Reserve Agent. The directors elect a Governor and other officers.

A branch has seven or less directors, of whom a majority of one is appointed by the parent bank and the remainder by the Federal Reserve Board. The Managing Director and other officers are elected by the parent bank.

The twelve reserve institutions are under general supervision of the Federal Reserve Board in Washington. The Board is composed of eight members—the Secretary of the Treasury and the Comptroller of the Currency, ex-officio members, and six others, who are appointed by the President with the advice and consent of the Senate. The latter six serve for terms of ten years each. They must be selected with due regard to a fair representation of the financial, agricultural, industrial and commercial interests, and the geographical divisions of the country.—*Extracts, see 2, p. 320.*

Additional Federal Banking Agencies

I. The Federal Farm Loan Board

THE membership of the Federal Farm Loan Board is as follows:

Ex-officio: Secretary of the U. S. Treasury,
Andrew W. Mellon, *Chairman*
Farm Loan Commissioner: Paul Bester.

L. J. Pettijohn, George R. Cooksey,
John H. Guill, A. C. Williams,
J. B. Madison.

IN response to a demand for a better system of farm mortgage credit, the Congress of the United States in 1916 passed the Federal Farm Loan Act. The Federal land banks, which are mutual or cooperative in character and the capital stock of which is held mainly by associations of borrowers, were organized under this act. For the purpose of administering the act and supervising the banks of the system, a Federal Farm Loan Bureau, under the supervision of the Federal Farm Loan Board, was established in the Treasury Department. This board is composed of the Secretary of the Treasury, who is chairman ex-officio, and six members appointed by the President by and with the advice and consent of the Senate. The board appoints appraisers and examiners; causes periodical examinations to be made of the banks and national farm loan associations; checks the appraised values of farms through its reviewing appraisers; approves mortgage loans as security for farm loan bonds; makes rules and regulations governing the operations of the banks and national farm loan associations; and exercises general supervisory authority over the system.

There are twelve Federal land banks, organized upon the cooperative plan, each making loans in a particular district. These banks make loans to farmers through local corporations which are chartered by the Federal Farm Loan Board, and which are known as national farm loan associations. Loans are made upon long-term, amortization plans of payment and are secured by first mortgages on farms. The mortgages and the promissory notes of the borrowers constitute the principal collateral behind Federal land bank bonds. The proceeds of these bonds sold to the public are the main source of funds for loaning operations.

In the fourteen years that these banks have been in operation, they have demonstrated their ability to provide farmers with mortgage credit at low interest rates. Since their organization they have closed approximately 512,196 loans in the aggregate amount of $1,653,900,000, and 410,493 loans totaling $1,187,438,688, were outstanding. Aside from their capital investment, the money lent by the Federal land banks has been furnished chiefly by the investing public through the purchase of their bonds.—*Extracts, see 5, p. 320.*

II. The Federal Intermediate Credit Bankers

THE Federal Intermediate Credit Banks, of which there are 12, were created pursuant to the provisions of the agricultural credits act of 1923, approved March 4, 1923.

The officers and directors of the Federal Land Banks are ex-officio officers and directors of the Federal Intermediate Credit Banks. General supervision of the Federal Intermediate Credit Banks, with broad powers of regulation, is vested by law in the Federal Farm Loan Board, consisting of six members appointed by the President by and with the advice and consent of the Senate, in addition to the Secretary of the Treasury, who is a member and chairman of the Board ex-officio. The banks are examined twice annually by examiners of the Federal Farm Loan Bureau, and the banks themselves make examinations from time to time of the corporations for which they discount paper.

The authorized capital of the Federal Intermediate Credit Banks is $5,000,000 for each bank, or a total of $60,000,000, all of which was subscribed by the Treasury of the United States. Of the subscribed capital only $30,000,000 has been paid in, the balance, $30,000,000, being subject to call, in whole or in part, by the directors of the banks, with the approval of the Federal Farm Loan Board, on thirty days' notice to the Secretary of the Treasury.

These banks were created for the purpose of providing agricultural credit at reasonable interest rates for periods that are intermediate between the usual maturities of short-term commercial bank loans and long-term farm mortgage loans. They are authorized:

(1) To make loans to cooperative marketing associations secured by warehouse receipts or shipping documents covering staple agricultural products, and

(2) To discount agricultural paper, under the limitations prescribed in the act, for banks, agricultural credit corporations, livestock loan companies, and other financing institutions, with their indorsement, or to make loans or advances to such institutions secured by such agricultural paper.—*Extracts, see 6, p. 320.*

III. The Postal Savings System - -

BETWEEN 1873 and 1910, 80 bills relating to the establishment of postal savings were introduced in Congress, the last of which was enacted into law in 1910.

The pioneer legislation of 1910 was naturally and inevitably quite restrictive. It has since been amended from time to time but certain features still seem to operate against the general welfare. Probably the change most needed in the light of full administrative experience is the raising of the amount—now $2,500—that may be placed to any one depositor's credit.

The administration of the Postal Savings System is by law divided into two parts. The Postmaster General is charged with the designation of post offices as postal savings depositories, the supervision of postal savings business transacted at depository post offices, and the conduct of the central administrative office at Washington. The Board of Trustees, consisting of the Postmaster General, the Secretary of the Treasury, and the Attorney General, is charged with the management and investment of postal savings funds after they leave the custody of postmasters. The Treasurer of the United States is treasurer of the Board of Trustees. The Third Assistant Postmaster General is the agent of the Board of Trustees for all purposes connected with the qualification of depository banks, etc.

The Postal Savings Act provides that postal savings funds shall be deposited in solvent banks, whether organized under national or State laws, being subject to national or State supervision and examination. The board of trustees shall take from such banks such security in public bonds or other securities, authorized by act of Congress or supported by the taxing power, as the board may prescribe, approve, and deem sufficient and necessary to insure the safety and prompt payment of such deposits on demand.

The funds received at the postal savings depository offices in each city, town, village, and other locality shall be deposited in banks located therein (substantially in proportion to the capital and surplus of each such bank) willing to receive such deposits under the terms of this act and the regulations made by authority thereof: *Provided, however,* If one or more member banks of the Federal Reserve System established by the act approved December 23, 1913, exists in the city, town, village, or locality where the postal savings deposits are made, such deposits shall be placed in such qualified member banks * * *, but if such member banks fail to qualify to receive such deposits, then any other bank located therein may qualify and receive the same.—*Extracts, see 7, p. 302.*

The Need for New Federal Banking Legislation - - Proposed Remedies Discussed

by J. W. Pole

DURING the past ten years and continuing at the present time bank failures have been a blight in the Mississippi Valley, the South, the Southwest and the Northwest. There are agricultural counties in which every bank has failed. In many cases it has been necessary to assess shareholders in order to keep banks alive and it has often happened that a failure occurred after as many as three such assessments had been paid in vain. The hardship which these failures have imposed upon depositors and upon those who invest their money in country bank stocks, over such a wide geographical area, is an indication that there is something seriously wrong with the system of banking in the rural districts.

These views are not primarily the result of recent research and the collection of information. I was myself a country banker. Later, as a national bank examiner and as Chief National Bank Examiner it became my duty to examine the affairs of hundreds of country national banks. For more than 20 years I have been in daily and intimate contact with the operations of our banking system. No one knows any better than I do that there are still strong and profitable country banks and if I had any prejudices they would naturally be in favor of the system of unit banking to the sustenance of which I have been devoted for so many years. It is with great reluctance that I have slowly come to the conclusion that our small independent unit country banks are no longer fulfilling the purposes of their creation and that there is need for a better, sounder and stronger system.

In order to avoid the impression that I am interested only in the national banks in this discussion, may I take this occasion to emphasize the fact that the statements I have made with reference to bank failures apply with equal if not greater force to state banks. The conditions which rural banking faces in the United States are the same for both national and state banks and, as between the two, the statistics will show that the national banks have shown the stronger resistance. The system under which rural banking as a whole is carried on does not provide a sufficient safeguard either to the depositors or to the shareholders nor does it offer a type of banking service adequate for modern conditions.

Many of the strong and well-managed country banks have found it necessary at times to discontinue making loans and to build up and carry large cash reserves for long periods of time. Due to the fear of "lack of confidence" and in their efforts to be prepared to withstand sudden withdrawals, some of these banks have restricted their operations to such an extent that they are of little benefit to the community in which they are located, and in some communities have practically ceased to function. Such banks are necessarily experiencing difficulty in earning a sufficient amount to cover operating expenses.

We are faced with a banking situation which applies almost entirely to the rural districts, although it should be borne in mind that there are also a considerable number of small banks in the larger cities, particularly in the outlying districts.

Attention is particularly directed to the circumstance that these failures of country banks are not embraced in a period of time which has been closed and upon which we may look only in retrospect. This error has been made by many writers in making reference to bank failures as though the failures arose out of some past condition, the chief significance of which is to furnish an argument for or against a system of banking. It is true that this period had a somewhat definite beginning which appears to be coterminous with the war period and is no doubt related to many of the changes in our social and economic life caused directly or indirectly by the war. Unfortunately, the period in which these failures have occurred and are occurring has not been brought to a close.

In considering the great flood of statistical information which must be studied in order to discover the causes and effects of bank failures there is the danger of losing sight of the human and social aspects of the situation. Every bank failure presents a distinct phenomenon to the local community. It is a local dramatic event. Whereas the supervising official may in many cases not be surprised that the bank has failed and the executive officers of the bank and perhaps the local board of directors have been struggling for months or years to keep the bank open, the actual failure comes as a complete surprise and a shock to the depositors and in most cases to those shareholders who are not officers or directors of the bank.

The losses from these bank failures fall upon the best and most substantial citizens in the community and many of them never recover their previous financial condition. A similar adverse effect is had upon the borrowers of a bank which fails. When a receiver is appointed his duty is to wind up the affairs of the bank and to enforce liquidation. Many of the borrowers may have been doing business with the bank for years and may have been upon intimate terms with the officers of the bank. This is especially true of the so-called character loans where the bank takes an interest in a person who has good character and good prospects but weak in collateral and who is accommodated each year or from time to time covering a considerable period. The character and reputation of such person may be unknown to other banks; therefore, the credit standing of this class of borrower for the time being is destroyed. The receiver must demand payment and if payment is not made he must institute suit and prosecute the case to judgment in order to gain as much as he can for the depositors. Notwithstanding every means is employed to soften the blow which the community has sustained, this enforced liquidation in country banks works a bitter hardship upon the borrowers—the very type of borrowers which it has been claimed the unit system of banking is particularly designed to protect.

Many causes have been assigned for these bank failures; in one section droughts, in another insect pests, in another failure of the cattle market, in another a drop in the price of wheat, and so on. A great many failures have been attributed to mismanagement, incompetent management or criminal management; some banks have been closed on account of single cases of defalcation and robbery; another cause assigned is that too many rural bank charters have been granted.

While these various factors may have been the immediate occasion for the closing of these banks they do not indicate the basic cause. If one observes the same type of small country bank, situated in various sections of the country, unable to keep open its doors one naturally would seek the reason of the general condition. Cannot the basic cause be found in the great economic and social changes which have come over this country within the past fifteen years—the war period and the post-war period? We have witnessed a revolution in the method of transportation and communication in the rural districts. Local communities which were at one time economically and socially independent have been put upon arterial highways which have drawn them close to the larger cities. It is now impossible for the country bank to gain that diversification in the banking business which was possible a few decades ago. The business of the small city is becoming more and more an adjunct of the business of the larger commercial centers. Opportunities for independent local financing are becoming fewer and fewer. The commercial business and the trust business are going to the large city bank. The country bank is left largely with real estate loans and small local loans.

If therefore these fundamental conditions have caused the business of the small bank to shrink to the point where it becomes unprofitable for the bank to operate we are met with a basic condition which cannot be cured by palliatives. Several remedies have been proposed to meet these conditions.

The remedy most frequently suggested as a protection to the depositor is some form of guarantee of bank deposits. This guarantee may take the form of compulsory insurance for the payment of deposits or compulsory contribution on the part of all banks to pay deposit losses in failed banks or a direct governmental guarantee under which the taxing power of the State would be used to pay losses to depositors in failed banks. Several of the States in the Union have enacted guarantee of deposit laws but in every case the operation of the law has proven unsuccessful.

A system of banking with a deposit guarantee superimposed upon the local bank by governmental authority under which some other instrumentality than the bank itself undertakes to insure the safety of deposits, will not prevent the local bank from failing if it cannot maintain a successful operation as a business enterprise. If local economic conditions are unfavorable to such a bank and if the loans are not properly made or become frozen after they are made with reasonable care, the bank will have to close its doors. No system of guarantee of deposits under such conditions will serve to keep the bank open. Laws involving the guaranty of deposits of State banks have been in operation in Kansas, Mississippi, Nebraska, North Dakota, Oklahoma, South Dakota, Texas and Washington, but, with the exception of Nebraska, I understand, such laws have been repealed.

Bills have been introduced in Congress providing for compulsory insurance for the shareholders' liability in national banks. The provisions of the National Bank Act fixing the individual liability of shareholders were enacted in 1864 as a part of the original Act. They fixed the individual liability in an amount equal to the par value of the shares held. This individual liability therefore is not equivalent to the value of the investment of the shareholder in the stock but simply to the original amount paid in by him. It was designed as a protection to the creditors of the bank but not as a full protection. For example where the deposit liability of the bank is in proportion to the capital of 10 to 1 it will be readily seen that the additional liability was not designed as a guaranty of the payment of bank deposits. The bank with $100,000 paid in capital and $1,000,000 of deposit liabilities would carry an additional individual liability upon its shareholders of only $100,000. To take an extreme case, if all of the capital and all of the deposits were wiped out by losses, the individual liability if realized in full would net the depositors only ten cents to the dollar.

As a practical matter the question of enforcement by the Comptroller of the Currency of this individual liability has been confined during the past 65 years almost entirely against the shareholders in small country banks. In winding up the affairs of 815 national banks the records of the Comptroller's office show that an average of 48.29 per cent has been collected from shareholders under their individual liability. These figures do not include numerous cases of assessments against shareholders to restore the impaired capital of going national banks.

It would seem therefore that the individual liability of the shareholders of national banks has been an inadequate protection to the depositors and where enforcement has been attempted, a great hardship upon the shareholders. Under a system of national banking created and supervised by the Government of the United States should not both the shareholder and the depositor enjoy a greater security?

Several students of the banking situation have suggested as a remedy a federal statute requiring a minimum capitalization of one hundred thousand dollars for national banks and a similar provision by the various States. The theory of this proposal is that such a provision will automatically decrease the number of country banks and will compel the formation of stronger banking institutions. Under this plan if the conventional ratio of 10 to 1 is maintained there would be no banks in the United States with deposits of less than one million dollars.

Such a plan to be successful would require complete legislative cooperation on the part of the state governments as the minimum capitalization of national banks has always been higher than that required as a rule by the state laws. The present minimum capitalization of twenty-five thousand dollars for national banks as now required is too high for state banks in many states. In other words, the present capital requirements for national banks has not had the effect of causing state legislatures to require the state banks to adopt a similar standard. On the contrary, Congress, by the act of March 14, 1900, reduced the minimum capital for national banks from $50,000 to $25,000 thus lowering the standard towards that of the States.

One of the most natural effects of such an increase to a one hundred thousand dollar minimum for national banks would be to cause hundreds of national banks to take out state charters and thus remain in operation. The operating condition of the banks in the rural districts are the same for both national and state banks and

any comprehensive remedy looking to an improvement of the rural banking situation must embrace directly or indirectly both state and national banks.

A banking institution from the standpoint of the investing shareholder furnishes a vehicle for the employment of capital. He invests his money in bank stock with the expectation of a reasonable return in dividends. From the standpoint of the Government, however, a bank possesses certain public responsibilities which the governments, state and national, have attempted to establish and protect by statutory enactment. If in the pursuance of this aim the Government requires a minimum capitalization too high for profitable employment in a given local community no bank would be operative there.

Thousands of communities in the United States where banks are now operating would be deprived of all local banking services if the minimum capital for country banks were placed at $100,000. This would mean that these local communities would be put to the inconvenience of going considerable distances, especially in the less densely populated agricultural States. Such a situation would naturally result in hoarding of funds and this would be a backward step in the development of the country. Banking develops business in a community and every community should have convenient access to banking services. In our desire to create a sound system of rural banking we must guard against the establishment of safety at the expense of the convenience of hundreds of thousands of citizens who ought to have immediate access to banking facilities.

Certain proposals have been put forward which recognize the difficulties which small country banks face in attempting to operate alone and independently and which suggest as a remedy an intensification of the correspondent system. Under this suggestion the country bank would through voluntary cooperation draw closer to the large city banks and receive from them through conferences and contact of personnel the proper guidance in the direction of safe and sound banking.

There has grown up over a long period of years the present system of bank correspondents in the United States. As a general rule the country bank is a correspondent of some New York bank as well as of other metropolitan banks in the large commercial centers. It is a business relationship which facilitates the interchange of credit and, with respect to New York City, large deposits of country banks are from time to time carried with the New York banks for temporary investment. Disregarding, however, the operation of depositing money on call in New York, the normal relationship between the country bank and its city correspondent may be reduced to about four elements: First, the deposit carried with the city bank upon which interest is paid to the country bank; second, the opportunity afforded to the country bank to purchase securities from or upon the advice of the city bank; third, the privilege given the country bank of borrowing from the city bank; fourth, the opportunity afforded the country bank of seeking the direction and guidance of the city bank in questions of bank policy and bank management.

The system of correspondent banks has been in full force and effect throughout the post-war period in which we have witnessed so many small bank failures. Each of these failed banks was a correspondent of a New York metropolitan bank and of other metropolitan banks. There was no obligation on these city banks to protect the local depositors of their country correspondents and no such efforts were expected to be made. The correspondent relationship is strictly a business transaction in which each party receives some advantage. The city banks are naturally interested in the policies and management of their country correspondents, but the amount of interest taken and the amount of constructive advice given in each case depends upon the value of the account of the country bank. The credit accommodation extended by the city bank is based largely on the credit balance maintained with it by the country bank.

The remedy most frequently suggested for the failure of small banks is the inauguration of better bank management. The principal advocates of this remedy are those familiar with or engaged in banking as it is carried on by the large city banks. Their study of the small bank situation—especially the small country banks—has shown certain weaknesses in management, such as lack of a sound and definite loan policy; the lack of adequate credit information; the failure to build up an adequate liquid secondary reserve of securities; a lack of adequate knowledge of the securities market; the failure to obtain a diversification of loans, that is to say, too great a proportion of the loans are made upon the same class of security or credit.

No one who has made a comprehensive study of small country banks can deny that the above conditions exist. Their chief significance, however, lies in their comparison with the operations of the metropolitan banks. It has never been convincingly pointed out exactly how these small country banks could adopt these more approved methods of banking. Educational campaigns have been suggested as a means of bringing the situation home to the country banker. In fact, discussion of improving country bank management has been going on for the past ten years with no very gratifying results.

The truth of the matter is that there has been developed in the United States, under the same banking laws, two definite types of banking, namely, that carried on by the small country bank and that of the large city bank. The independent country bank situated in small towns and villages and serving a limited area, rural in character, is necessarily restricted to only a limited type of banking.

On the other hand, the metropolitan city bank has become a most complex instrumentality of finance. It does everything that the country bank could do and engages in a multitude of activities besides. It employs a large personnel and establishes different departments each under the administration of an expert in that field. The president of a metropolitan bank is in the position of an executive of a great business, supervising and directing the operations of its various departments.

How can we compare the operations of such a bank (with resources above fifty million dollars, in addition to its administration of many millions of trust assets) with a country bank of two hundred and fifty thousand dollars of resources in a town of one thousand population? To invite the small bank to adopt the efficient methods of the large city bank would be to ask it to lift itself by its own bootstraps. As a remedy for country bank failures the establishment of improved banking methods is theoretically sound, but impossible practically of general realization. The business is too small in volume, too limited in diversity and too circumscribed geographically to create a normal motive for the establishment of the high type of management possessed by the city banks.—*Extracts, see 4, p. 320.*

Developments in President Hoover's Program to Stabilize Credit

1931—In September President Hoover began working on a plan to relieve the banking situation. He conferred with a number of Government officials and individuals and finally worked out a program.

On October 2, the outline of the plan was determined upon. This outline included three features: (1) the co-operation of the Government's financial agencies, the Treasury, the Federal Reserve Board and the Farm Loan Board; (2) the action of the banks of the country in providing a minimum fund of $500,000,000 for co-operative aid among the banks; (3) a program of legislative action.

On October 4 (Sunday) President Hoover, departing from precedent, visited the Secretary of the Treasury, Andrew W. Mellon, at his home on Massachusetts avenue, where a group of prominent bankers had been summoned to meet him. When the President had laid his program before them, the bankers agreed to appoint a small committee in New York, headed by Governor Harrison, of the Federal Reserve Bank of New York, to consider the plan.

On October 6, the committee of New York bankers met at the New York Clearing House. The twenty-four prominent bankers present endorsed the plan.

In response to a call from President Hoover a number of U. S. Senators and Representatives met at the White House that evening and were informed of the program. They agreed to accept in principle his suggestions for legislative action.

On October 7, the President made his plan public. (*See statement on page 301.*)

On October 7, the Committee of Bankers in New York announced that: In accordance with the President's request, bankers in New York assumed the leadership in the formation of the $500,000,000 corporation proposed by the President. Gov. George L. Harrison, of the Federal Reserve Bank of New York, announced the formation of a committee of bankers to carry out the plan. The committee consists of Mortimer N. Buckner, president of the New York Clearing House Association and chairman of the New York Trust Co.; Charles S. McCain, of the Chase National Bank; Harry E. Ward, president of the Irving Trust Co.; George W. Davison, president of the Central Hanover Bank & Trust Co.; Herbert P. Howell, president of the Commercial National Bank & Trust Co., and Gordon S. Rentschler, president of the National City Bank.

In announcing the formation of the committee, Governor Harrison issued the following statement:

"President Hoover has requested the bankers of the Nation to form a national institution of at least $500,000,000 for the purpose of rediscounting for banks, when necessary, sound assets not now legally eligible for rediscount at the Federal reserve banks. He has also requested the bankers of New York to assume the leadership in the formation of such a corporation.

"Progress has already been made toward the immediate organization of the corporation and the development of the procedure by which it may promptly and effectively operate in various sections of the country. It is contemplated that there will be a board of directors of 12 members, one from each Federal reserve district, to be selected by the organization committee.

"All banks throughout the country will shortly be asked to participate in this undertaking by subscribing to the extent of 2 per cent of their net demand and time deposits. The members of the New York Clearing House Association have evidenced their unanimous support by agreeing to participate to the extent of $150,000,000."

Editor's Note: The proposed plan for the organization and operation of the national credit organization was published in detail in the Federal Reserve Bulletin of October, 1931.

On October 8, the Chicago Clearing House voted unanimously to participate in the credit corporation.

On October 9, Mortimer N. Buckner, chairman of the Bankers' Committee, announced that $800,000,000 had already been pledged for the credit corporation, whereas subscriptions to $500,000,000 only had been requested.

On October 13, the Comptroller of the Currency, after a question had arisen concerning the participation in the credit corporation by national banks, issued a statement declaring that the plan was a meritorious one and deserved the support of the national banks.

On October 13, application for a charter for the National Credit Corporation was filed in Delaware and was granted.

On October 14, copies of the plan of organization were mailed to all clearing house associations with subscription blanks for notes of the corporation.

On October 17, the directors of the National Credit Corporation held their first formal meeting at the Federal Reserve Bank in New York and organized. The officers elected were: Mortimer M. Buckner, New York, president; George M. Reynolds, Chicago, chairman of the board of directors; Daniel G. Wing, Boston, and Walted W. Smith, St. Louis, vice-presidents; Nelson S. Dearmont, secretary and treasurer. Daniel G. Wing, Boston; Livingston E. Jones, Philadelphia; Arthur E. Braun, Pittsburgh; John K. Ottley, Atlanta, and Frank B. Anderson, San Francisco, with the president and chairman of the board constitute the executive committee.

On November 7, the National Credit Corporation formally opened for business at its headquarters in the Federal Reserve Bank Building in New York. Mortimer N. Buckner, president, announced that $400,000,000 of subscriptions to the corporation's sold notes had been received from banks throughout the country and that the total subscriptions were expected to reach $600,000,000.

On November 14, President Hoover announced his plan for the aid of home building credits, his second step toward relief of the general financial situation. This is separate and distinct from the National Credit Corporation. A full description of the home building credits plan will be found on page 303.

President Hoover Presents His Stabilization Program

THE prolongation of the depression by the succession of events in Europe, affecting as they have both commodity and security prices, has produced in some localities in the United States an apprehension wholly unjustified in view of the thousand-fold resources we have for meeting any demand. Foolish alarm in these sections has been accompanied by wholly unjustifiable withdrawal of currency from the banks. Such action results in limiting the ability of the banks in these localities to extend credit to business men and farmers for the normal conduct of business, but beyond this to be prepared to meet the possibility of unreasoning demands of depositors the banks are compelled to place their assets in liquid form by sales of securities and restriction of credits so as to enable them to meet unnecessary and unjustified drains. This affects the conduct of banking further afield. It is unnecessary to specify the unfortunate consequences of such a situation in the districts affected both in its further effect on national prices of agricultural products, upon securities, and upon the normal conduct of business and employment of labor. It is a deflationary factor and a definite impediment to agricultural and business recovery.

There is no justification for any such situation in view of the strength of our banking system and the strong position of our Federal reserve system. Our difficulty is a diffusion of resources and the primary need is to mobilize them in such a way as to restore in a number of localities the confidence of the banker in his ability to continue normal business and to dispel any conceivable doubt in the mind of those who do business with him.

In order to deal wtih this wholly abnormal situation and to bring about an early restoration of confidence, unity of action on the part of our bankers and cooperative action on the part of the Government is essential. Therefore, I propose the following definite program of action, to which I ask our citizens to give their full cooperation:

1. To mobilize the banking resources of the country to meet these conditions, I request the bankers of the nation to form a national institution of at least $500,000,000. The purpose of this institution to be the discount of banking assets not now eligible for rediscount at the Federal reserve banks in order to assure our banks, being sound, that they may attain liquidity in case of necessity, and thereby enable them to continue their business without the restriction of credits or the sacrifice of their assets. I have submitted my proposal to the leading bankers of New York. I have been advised by them that it will receive their support, and that at my request they will assume the leadership in the formation of such an organization. The members of the New York City Clearing House Association have unanimously agreed to contribute their share by pledging $150,000,000, which is 2 per cent of their net demand and time deposits. I have been assured from other large centers, as far as I have been able to reach, of their support also. I consider that it is in the national interest, including the interest of all individual banks and depositors, that all the banks of the country should support this movement to their full responsibility. It is a movement of national assurance and of unity of action in an American way to assist business, employment, and agriculture.

2. On September 8, I requested the governors of the Federal reserve banks to endeavor to secure the cooperation of the bankers of their territory to make some advances on the security of the assets in order that the receivers of those banks may pay some dividends to their depositors in advance of what would otherwise be the case pending liquidation. Such a measure will contribute to free many business activities and to relieve many families from hardship over the forthcoming winter, and in a measure reverse the process of deflation involved in the tying up of deposits. Several of the districts have already made considerable progress to this end, and I request that it should be taken up vigorously as a community responsibility.

3. In order that the above program of unification and solidarity of action may be carried out and that all parts of the country be enlisted, I request the governors of the Federal reserve banks in each district to secure the appointment of working committees of bankers for each reserve district to cooperate with the New York group and in carrying out the other activities which I have mentioned.

4. I shall propose to the Congress that the eligibility provisions of the Federal reserve act should be broadened in order to give greater liquidity to the assets of the banks, and thus a greater assurance to the bankers in the granting of credits by enabling them to obtain legitimate accommodation on sound security in times of stress. Such measures are already under consideration by the Senate Committee on Currency and Banking.

5. Furthermore, if necessity requires, I will recommend the creation of a finance corporation similar in character and purpose to the War Finance Corporation,* with available funds sufficient for any legitimate call in support of credit.

6. I shall recommend to Congress the subscription of further capital stock by the Government to the Federal land banks (as was done at their founding) to strengthen their resources so that on the one hand the farmer may be assured of such accommodation as he may require and on the other hand their credit may be of such high character that they may obtain their funds at low rates of interest.

7. I have submitted the above-mentioned proposals which require legislation to the Members of Congress whose attendance I was able to secure on short notice at this evening's meeting (October 7)—being largely the members of committees particularly concerned—and they approve of them in principle.

*For description of War Finance Corporation see next page.

8. Premier Laval of France is visiting the United States. It is my purpose to discuss with him the question of such further arrangements as are imperative during the period of the depression in respect of intergovernmental debts. The policy of the American Government in this matter is well known and was set out by me in a public statement* on June 20 in announcing the American proposal for a year's postponement of debt payments. Our problem in this respect is one of such adjustment during the period of depression as will at the same time aid our own and world recovery. This being a subject first of negotiation with foreign governments was not submitted for determination at this evening's conference.

9. The times call for unity of action on the part of our people. We have met with great difficulties not of our own making. It requires determination to overcome these difficulties and above all to restore and maintain confidence. Our people owe it not only to themselves and in their own interest, but they can by such an example of stability and purpose give hope and confidence in our own country and to the rest of the world.

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Work of the War Finance Corporation Reviewed

by George R. Cooksey

THE War Finance Corporation, an agency of the United States Government, was created in 1918 to give financial support to industries whose operations were "necessary or contributory to the prosecution of the war" and to banking institutions that aided in financing such industries. It was authorized also to make advances to savings banks and building and loan associations, to buy and sell obligations of the United States Government, and to issue its own bonds. Its paid-in capital was fixed at $500,000,000, all of which was subscribed by the Government, and provision was made for the administration of its activities through a board of five directors, with the Secretary of the Treasury as an ex-officio member and chairman of the board. The corporation was in existence only six months before the armistice was signed, but even in that short period it handled a large volume of business and fulfilled a useful and effective function in the program of war finance. When hostilities ceased, its operations were contracted automatically, but its continued usefulness was soon demonstrated when it was called upon to undertake the burden of financing the railroads, then under Federal control, because of the temporary failure of the Congress to make an appropriation for the maintenance of their operations.

Under its war-time powers, the corporation made advances totaling $306,771,211. Its authority to buy and sell obligations of the United States Government also was exercised on a large scale, the corporation serving as an intermediary between the "Bond Purchase Fund" of the Treasury and the open market for Government securities, purchasing bonds wherever such action was necessary in order to stabilize the market and later turning them over to the Treasury for retirement when the condition of the Bond Purchase Fund permitted. Altogether, the corporation bought from May 22, 1918, to April 16, 1920, Government securities having an aggregate par value of $1,889,122,000.

In March, 1919, in order that it might assist in the transition from the conditions of war to the new conditions of peace, the corporation was granted authority by the Congress to make advances, to the extent of $1,000,000,000, to American exporters and to American banking institutions which extended credits to finance American exports. A number of loans were made under this authority. The activities of the corporation were discontinued in May, 1920, at the request of the then Secretary of the Treasury. In January, 1921, the Congress passed a joint resolution directing the corporation to resume operations. Its powers, which were then restricted to the financing of exports, were subsequently enlarged by the passage of the Agricultural Credits Act in August, 1921, which authorized it to make loans for agricultural purposes to banking and financing institutions, including live stock loan companies, and to cooperative marketing associations.

The corporation's activities under this act were conducted on a nation-wide scale. It approved advances for agricultural and live stock purposes aggregating $479,642,000, of which $298,659,000 was advanced. These advances reached the farmers and stockmen through 4,317 banks, 20 cooperative marketing associations, and 114 live stock loan companies. In addition, the corporation, after the resumption of operations in January, 1921, authorized loans totaling $58,374,255, of which $38,654,000 was advanced, to assist in financing exports, principally of grain, tobacco, cotton, and other agricultural products.

The Agricultural Credits Act of August 24, 1921, provided that the corporation should cease active operations on July 1, 1922. The Congress, however, by the Act of June 10, 1922, extended until June 30, 1923, the period during which it was authorized to make loans, and this period was further extended to March 31, 1924, by the Agricultural Credits Act of 1923, and to December 31, 1924, by the Act of February 20, 1924. In accordance with the terms of the latter act, the corporation discontinued the making of new loans and entered the period of liquidation on January 1, 1925. Since that date the only advances that have been made are those designated as "expense advances," that is, advances necessary for the care and preservation of the corporation's security in connection with the orderly liquidation of its assets and the winding up of its affairs.

Under the original Act, the corporation's charter was limited to a period of ten years from the passage of the Act on April 4, 1918. On April 4, 1928, the President approved a bill extending the Corporation's charter for a period of one year and by an act approved March 1, 1929, the liquidation of the assets remaining at the close of April 4, 1929, and the winding up of the affairs of the

corporation thereafter, were transferred to the Secretary of the Treasury, who for such purpose was given all the powers and duties of the board of directors of the corporation. For carrying out the provisions of the latter act, the Secretary of the Treasury, pursuant to authority contained in said act, assigned to a liquidating committee the exercise and performance, under his general supervision and direction of all such powers and duties.

On January 5, 1925, the corporation, with the approval of the Secretary of the Treasury, canceled and retired $499,000,000 of its capital stock, leaving $1,000,000 outstanding. On April 5, 1929, the corporation canceled and retired $990,000 additional of its capital stock, leaving $10,000 outstanding. On the same date, the corporation paid into the Treasury all moneys belonging to it which, in the opinion of the Secretary of the Treasury, were not required for carrying on and completing the liquidation of its remaining assets and the winding up of its affairs, including reasonable provision for the further expenses thereof.

The Liquidating Committee of the Corporation is composed of George R. Cooksey, Chairman, and A. C. Williams, both of whom are members of the Federal Farm Loan Board.

The Next Step in the President's Program - - Discount Banks to Aid Home Building

I SHALL propose to Congress the establishment of a system of home loan discount banks for four purposes:

1. For the present emergency purpose of relieving the financial strains upon sound building and loan associations, savings banks, deposit banks, and farm loan banks that have been giving credit through the medium of small mortgage loans upon urban and farm properties used for homes. Thereby to relieve pressures upon home and farm owners.

2. To put the various types of institutions loaning on mortgage in a position to assist in the revival of home construction in many parts of the country and with its resultant increase in employment.

3. To safeguard against the repetition of such experience in the future.

4. For the long-view purpose of strengthening such institutions in the promotion of home ownership particularly through the financial strength thus made available to building and loan associations.

□

The immediate credit situation has for the time being in many parts of the country restricted severely the activities of building and loan associations, deposit banks, including country banks, and savings departments, savings banks and farm loan companies in such a fashion that they are not only not able to extend credit through new mortgages to home and farm owners but are only too often unable to renew mortgages or give consideration to those in difficulty with resultant great hardships to borrowers and a definite depreciation of real estate values in the areas where such pressures exist.

□

A considerable part of our unemployment is due to stagnation in residential construction. It is true there has been some overbuilding in certain localities in the boom years. But even in these localities the inevitable need is obscured by the tendency of the population to huddle temporarily, due to unemployment. The real need steadily accumulates with increasing population and will become evident and insistent as we come out of the depression. The high importance of residential construction as a matter of employment is indicated by the fact that more than 200,000 individual homes are erected annually in normal times, which, with initial furnishing, contribute more than $2,000,000,000 to our construction and other industries. This construction has greatly diminished. Its revival would provide for employment in the most vital way.

As a people we need at all times the encouragement of home ownership, and a large part of such action is only possible through an opportunity to obtain long-term loans, payable in installments. It is urgently important, therefore, that we provide some method for bringing into continuing and steady action the great facilities of such of these great national and local loaning concerns as have been under pressure and should provide against such difficulties in the future.

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The farm mortgage situation presents many difficulties to which this plan would give aid.

I have consulted with representatives of the various groups granting credit on mortgage loans for the home and farm as well as Government officials and other economic agencies, and as a practical solution from the various needs and the various ideas advanced, I propose the following general principles for the creation of an institution for such purposes.

(a) That there be established twelve home loan discount banks (if necessary), one in each Federal Reserve District, under the direction of a Federal Home Loan Board.

(b) The capital of these discount banks shall be initially of minimum of $5,000,000 to $30,000,000 as may be determined by the Federal board upon the basis of the aggregate of such mortgage loans and probable needs of the particular district.

(c) The proposed discount banks to make no initial or direct mortgages but to loan only upon the obligations of the loaning institutions secured by the mortgage loans as collateral so as to assure and expand the functioning of such institutions.

(d) Building and loan associations, savings banks, deposit banks, farm loan banks, etc., may become members

of the system after they have satisfied the conditions of qualifications and eligibility that may be fixed by the Federal board.

(e) The mortgage loans eligible for collateral shall not exceed $15,000 each and shall be limited to urban and farm property used for home purposes.

(f) The maximum amount to be advanced against the mortgage collateral not to exceed more than 50 per cent of the unpaid balance on unamortized or short term mortgage loans and not more than 60 per cent of the unpaid balance of amortized long term mortgages, and no advance to be made on mortgages in default. Such loans are to be made on the basis that there are sound appraisals of the property upon which such mortgages have been made. In other words, given sound appraisals, there will be advanced in the case of short term or unamortized loans 25 per cent of the appraisal and in case of amortized long term loans, 30 per cent of the appraised value of the property.

(g) The discount banks as their needs require from time to time to issue bonds or short term notes to investors to an amount not to exceed in the aggregate twelve times the capital of the issuing bank. The bonds of these Discount Banks would be thus secured by the obligations of the borrowing institutions, the mortgages deposited as collateral against such obligations and the capital of the Discount Banks. These bonds to be acceptable for security for Government and postal deposits. The result would be a bond of high grade as to quality and security.

(h) If the aggregate initial capital of the Discount banks should, in the beginning, be fixed at $150,000,000 it would be possible for the twelve banks to finance approximately something over $1,800,000,000 of advance to the borrowing institutions, which could be further expanded by increase in their capital.

(i) It is proposed to find the initial capital stock for the Discount banks in much the same way, insofar as is applicable, as the capital was found for the Federal Reserve banks—that is, that an organization committee in each district should first offer the capital to the institutions which would participate in the service of the bank. And as was provided in respect to the Federal Reserve banks, if the initial capital is not wholly thus provided, it should be subscribed by the Federal Government; and further, somewhat as was provided in the case of the Federal Land banks other institutions using the facilities of the Discount banks should be required to purchase from time to time from the Government some proportionate amount of its holdings of stock if there be any. In this manner any Government capital will gradually pass over to private ownership as was the case in the Federal Land banks.

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The above details of the proposal are put forward as suggestions in order to give clarity to the central idea rather than as inflexible conclusions. The whole plan would necessarily be subject to the action of Congress and many parts of it will no doubt need development.

There is no element of inflation in the plan, but simply a better organization of credit for these purposes.

This proposed institution does not in any way displace the National Credit Association, which occupies an entirely different field of action.

Action by Last Congress on Banking Question

by Charles Wallace Collins

FOLLOWING the recommendations of the President of the United States, the Secretary of the Treasury and the Comptroller of the Currency, the House of Representatives adopted a resolution on February 10, 1930, authorizing the Committee on Banking and Currency to conduct an investigation into the questions of branch, group, and chain banking with a view to the need for new legislation. The Committee held its first meeting on February 25, 1930, and continued in session until the early part of June.

The Senate Committee on Banking and Currency has been authorized by a resolution of the United States Senate to conduct also an investigation into the banking systems including especially the credit policies of the Federal Reserve System. It is authorized to proceed on a wide scope, the range of subjects embracing the consideration of all of the fundamentals of banking. The authority to sit is extended to the future sessions of Congress or during its recesses and vacations until a final report is reached. This investigation is still in progress.

The House hearings have presented the following questions for legislative consideration:

1. The adaptation of branch banking as a remedy for defects of rural unit banking.

2. The extension of the branch banking policy of the McFadden Act to embrace wider areas.

3. The use of the national banking system as an instrumentality in the application of a Federal branch banking policy without regard to state legislation or political boundary lines.

4. The status of group banking in the determination of a new banking policy.

Four years ago Congress permitted national banks in certain large cities to operate branches (McFadden Act). It conditioned branch banking by national banks upon the prior act of a state legislature permitting branch banking in such a city to state institutions. The question now before the country is the adaptation of that policy to banking conditions outside of the large cities.

The Comptroller of the Currency has recommended that the rural communities surrounding the commercial centers be permitted to enjoy the direct operative benefits of the large city banks therein situated. Under his plan Congress would empower the large national banks to become the head offices of systems of branches embracing both city and rural territory.

The present investigation will bring Congress face to face with the issue involved in the proposed abandonment of the policy of parity between national and state bank legislation as it affects national banks. Although the

National Bank Act was enacted purely as a Federal measure and in face of the opposition of the state banks, the subsequent development of state banking institutions began to have influence upon the national legislature.

It is difficult for the national banking system to obtain legislative relief upon recommendation made by the Comptroller of the Currency if these recommendations are in conflict with the interests of the state banks, for in every Congressional district there will be found a greater number of state than national banks.

The Comptroller of the Currency has recommended to Congress the abandonment of the so-called theory of parity and has urged the consideration of new branch banking powers for national banks solely upon their merits.

Congress is asked to take under consideration the grant of a new national banking power solely upon the basis of a public need, although in so doing it may give to the national banking charter an advantage which state banks may not possess.

Congress now has a great opportunity with the support of public opinion to initiate and enforce a uniform standard of commercial banking for the country as a whole.—*Extracts, see 8, p. 320.*

Prospects for Banking Legislation in New Congress

by Hon. Louis T. McFadden

WHILE it is impossible before Congress meets to venture any sort of reliable prediction as to what legislation the incoming Congress will finally enact to cover the various banking problems there are certain phases of the problem that are sure to receive attention during the session which begins on December 7, whether they are finally disposed of or not.

Naturally, the several suggestions already made by President Hoover for legislative action, suggestions which he has said he will embody in messages to Congress, will be considered. Among those already mentioned by the President are the following:

The creation of a governmental finance corporation similar to the War Finance Corporation; the subscription of further stock in the Federal Land Banks and the strengthening of the Farm Loan Board system, and the creation of a system of Federal banks to handle real estate and home building loans.

If the National Credit Corporation, organized by the banks operates successfully it is probable that there will be no need for placing a governmental finance corporation in operation. To guard against any contingency, however, it is expected that the President will want Congress to give him the authority so that if conditions arise which warrant the setting up of such an agency he will be able to do so without loss of time.

Bills to strengthen the farm loan system were before the House Committee on Banking and Currency during the last Congress, the principal one being that introduced by Representative Henry B. Steagall of Alabama, ranking Democrat on the committee. These measures will undoubtedly be reintroduced early in the coming session and are sure to receive consideration.

The President's suggestion for the creation of home loan discount banks under the direction of a newly created Federal Home Loan Board is sure to receive attention. Plans to aid home builders are being considered by the subcommittee of the Senate Committee on Banking and Currency but, as I understand it, they differ from the President's plan in that they would have the home building loans handled by the Federal Farm Loan Board, whereas the President's plan contemplates the creation of a separate board for the special purpose of handling home loans.

In his announcement of his plan for the establishment of the National Credit Corporation, the President indicated that he would recommend to Congress the broadening of the Federal Reserve base to permit the acceptance by the Federal Reserve System for rediscount certain additional types of securities which are not now eligible for rediscount.

There appears to be some confusion on this point, but whether the President recommends it or not it is sure to come before Congress, as several members of the House and Senate are in favor of increasing the list of eligible securities and will undoubtedly offer measures to that effect. What will be the result cannot be foretold. There will be strong opposition to them on the part of many members of both Houses.

From two other sources recommendations for legislation on banking questions are expected, the Federal Reserve Board and the subcommittee of the Senate Committee on Banking and Currency. This committee, working under a resolution adopted by the Senate giving it authority to investigate the entire banking problem, has been and still is conducting hearings and a preliminary report from it is expected soon after Congress convenes.

During the past Congress the House Committee on Banking and Currency conducted exhaustive hearings on the question of branch, chain and group banking. It was the original purpose of the committee to follow this with further hearings on every phase of the banking question. The resolution under which the hearings were held, however, limited the committee to branch, group and chain banking.

The committee members feel that we have barely scratched the surface. If the Republicans organize the House and I remain chairman of the committee, I will introduce a resolution asking authority to continue the investigations. If the Democrats gain control of the committee a similar request will doubtless be made by the Democratic chairman.

At the close of the last session we filed the committee hearings as our report. It seems probable that some legislation extending the area into which banks may extend branches will be offered during the coming session; also legislation to bring security corporations, affiliated with national banks, under the control of the Comptroller of the Currency.

A Glossary of Banking Terms

Branch Bank—A bank operating one or more branch offices which perform functions similar to those of the parent bank is engaged in branch banking. Branch managers are generally given limited discretionary powers in extending credit. Liabilities incurred by the branch are liabilities of the parent bank. National banks are not permitted to establish branches, and in a number of States branch banking is prohibited by the State banking code. In some States banks are permitted to establish branches located only in the home city of the parent bank, in others only within the county of the parent bank, while several States permit State-wide branches.

Chain Banks—A number of banks owned or controlled by the same individual or group of individuals. Chain bank systems have usually prevailed in rural districts.

Investment Bank—The investment bank undertakes to raise funds to provide for the fixed capital requirements of enterprises. The investment banker deals principally in stocks and bonds as distinguished from the short-term bills on which the commercial banker extends credit.

National Bank—A bank incorporated under the National Bank Act, primarily as a commercial bank of deposits and discount. It is authorized to issue national bank notes secured by a deposit of United States bonds. It is subject to general supervision and examination by the Comptroller of the Currency, and is required to report its condition on call to the Comptroller. Under the Federal Reserve Act its functions have been extended. The Federal Reserve Board may approve applications of national banks for permission to exercise fiduciary powers as trustee executor, administrator, or in any other fiduciary capacity in which competing State banks, trust companies, or other corporations are permitted to act under State laws. National banks may also receive time deposits, and to this extent they function as savings banks.

Private Bank—No very precise definition can be given which will accurately distinguish the private banks from other banks, but generally, if not in all cases, the private bank is one which is not regularly incorporated under the banking laws of any State, and in some cases at least it is not subject to any regular supervision by State banking authorities.

Savings Bank—A bank organized to receive deposits under special conditions reserving to the bank the right to demand notice of withdrawal for a specified period in advance. In the older eastern States a savings bank is understood to be a "mutual savings bank," organized without capital stock. Outside of this territory with few exceptions "savings banks" are stock corporations, and in some States there is not much distinction between savings banks and other banks. Deposits are not subject to checking out, but can be withdrawn only by production of the depositor's pass book in which proper entries are made. Savings banks operate under special provisions as to reserves and as to securities eligible for investment of their resources. Since their liabilities are not strictly demand obligations they are permitted to operate on a lower reserve ratio, and to invest more freely than commercial banks in securities of long maturity.

State Bank—A bank chartered under State laws, and subject to supervision and examination by a State banking department. Its powers and functions are defined in the State Banking Code. While the scope of its activities is in some States much more comprehensive than that of a national bank, the principal distinguishing characteristic must be found in the agencies of corporation, supervision, and examination.

Trust Company—Trust companies are incorporated under State laws. At the present time, they very commonly engage in a general banking business, including commercial, savings, and investment banking. They act as trustees or agents for individuals or corporations, and exercise the fiduciary powers noted under "national bank."

Unit Bank—A bank operating without branches, whose "principal" place of business is, therefore, its only place of business, and in a number of States the only place in which the bank may legitimately transact any of its business, is engaged in unit banking, and this characteristic of the unit bank distinguishes unit banking, which is very generally practiced in the United States from branch banking which is almost universal in other commercial countries.

Bank Examiner—An officer whose function it is to examine banks and report on their condition, in the case of national banks, for example, to the Comptroller of the Currency, and in the case of State banks to the proper State banking authorities.

Clearing House—A voluntary association of banks located in the same city joined together to facilitate the daily exchange of checks, drafts, and notes among its members, instead of separate exchanges being made directly by each bank with the others. A clearing house may be defined as a device to simplify and facilitate the daily exchanges of items and settlements of balances among the banks and a medium of united action upon all questions affecting their mutual welfare. The tendency has been marked, especially in recent years, to include within the legitimate field of clearing houses all questions affecting the mutual welfare of the banks and the community as a whole.

The object of the New York Clearing House Association (founded in 1853), which is typical of all, is set forth in its constitution as follows: The affecting at one place, of the daily exchanges between the members thereof and the payment at the same place of the balances resulting from such exchanges, the promotion of the interests of the members and the maintenance of conservative banking through wise and intelligent cooperation.

At the New York Clearing House there are three exchanges daily, at 9 A. M., 10 A. M., and 3 P. M. The 9 o'clock clearing is an early clearing for delivery of checks only by banks whose volume of exchanges is especially heavy. There is merely an exchange of checks for which receipts of delivery are given, no settlement being made. The main clearing in which all member banks participate is at 10 A. M. At this time settlement is made for checks delivered 9 A. M. and at the 3 P. M. clearing of the previous day.

The following is a brief outline of the procedure involved in the process of clearing. A bank receives through the course of business each day a great volume of checks payable at other banks in the city. To collect these checks by presentation at each bank would be a laborious and expensive process. The clearing house is a device whereby the banks in a city congregate to

mutually exchange these checks among them, settling in cash or the equivalent of cash for differences. Prior to the hour of clearing, each bank prepares the checks drawn on other banks in the city by sorting them into separate piles and obtaining an adding machine total for the aggregate. This is attached to the bundle of checks, which are placed inside a large envelope bearing the name of the bank to which presentation will be made at the clearing house. The amount of the checks is also written thereon. After each bank has prepared its checks for the clearing, it delivers them to the clearing house. Upon arrival at the clearing house, each participating bank deposits with the clearing house manager a credit ticket showing the total amount of checks it has brought to the clearing house against all other banks. This constitutes the bank's credit at the clearing house. The clearing house manager then lists the credits of each bank upon the clearing house proof in the credit column under the general heading Credit, Amounts Brought.—(*Munn*)

Discount—This term has several meanings:

(1) *Cash Discount.*

(2) *Bank Discount.* Interest paid in advance, or more accurately, interest paid at the beginning of a loan based upon the sum to be repaid at its maturity. The rate of discount charged by a bank is not the same as the rate of interest paid by the borrower. Interest retained by the lender at the time a note, acceptance or bill of exchange is discounted and the proceeds given to the borrower, and not at maturity. The interest so taken is called discount, or bank discount. For illustration, suppose a $10,000 note maturing in six months is discounted at 6 per cent. The discount would be .03 of $10,000, which is $300, the proceeds being the balance, or $9,700. Although this is the commercial or bank method of computing discount, it is not mathematically correct, inasmuch as the borrower is paying interest in advance of the use of the funds, and, therefore, pays interest upon interest. True discount, explained below, is the accurate method of computing interest paid in advance.

(3) *True Discount.* This differs from bank discount in that interest is computed on the proceeds or amount borrowed and does not entail the payment of interest upon interest. In principle it is the same as determining the present worth of a sum of money due on a future date. In the example used in illustrating bank discount, true discount is found first by computing the proceeds. This is ascertained by dividing $10,000 by 1.03 (1 representing the principal and .03 representing the interest on $1.00 for six months at 6 per cent.) which is $9,700.87. The true discount is the slightly more favorable to the borrower than bank discount, which, conversely, is more favorable to the lender.

(4) *Discount on Securities.* An expression used to indicate the amount or percentage which a security sells below par value, being the opposite of premium. A bond of $1,000 par value selling at 90, is at a 10 per cent. or $100 discount. A stock of $25 par value, selling at 24, is at 4 per cent. or $1.00 discount.

To the issuer bond discount represents deferred interest, because the issuing organization must retire the bonds at par, thereby decreasing the effective interest rate. The discount upon the issue should logically be accumulated during the life of the bonds as an additional interest charge. This process is called accumulation.

When stock is sold at discount by the issuing corporation, the amount of discount becomes in reality a deficit. It is usually offset, however, by some fictitious asset, e. g., good will.

(5) Paper money is at a discount when it does not circulate at par with the standard money or other metallic currency.

When more than a dollar of paper money must be must be given in order to purchase a dollar of standard money, paper money is at a discount.—(*Munn.*)

Rediscount—A term given to the process of discounting a second time, commercial paper (notes, acceptances, and bills of exchange) by one bank for another, or by a Federal Reserve bank for a member bank; also to such rediscounted paper itself. Since the Federal Reserve System has been in operation the term applies almost solely to the discounting of paper by a Federal Reserve bank for a member bank. In substance, however, any note is rediscounted whenever an indorser negotiates it.—(*Munn*)

Federal Reserve Bank Note—Notes issued by Federal Reserve Banks under provisions of the Federal Reserve Act. They are similar to national bank notes in that they are secured by United States bonds. The amount outstanding is relatively inconsiderable.

Federal Reserve Note—A currency note issued by a Federal Reserve Bank secured by a deposit of collateral in the form of eligible commercial paper, or gold, or gold certificates, with a Federal Reserve agent. These notes are Government obligations and a paramount lien on all the assets of the bank.

Holding Company—A company the business of which is to own the stocks or securities of other companies, the interest or dividends upon which constitute the income of the holding company.

Greenback—A note issued by the United States Government which is a legal tender for all debts, public and private, except duties on imports and interest on the public debt. It is a legacy of the Civil War period. Since resumption of specie payments in 1876, some $346,000,000 of these notes have been outstanding. Against these notes the Government holds a gold reserve of approximately 45 per cent.

National Bank Note—A currency note secured by a deposit of United States bonds with the Treasurer of the United States, issued by a national bank under provisions of the National Bank Act.

Parity—The term parity as used in discussions of the banking question means equality between national and state banks, the object of the demand for parity being to so change the National Banking Laws as to give the national banks the same privileges enjoyed by state banks.

Security Affiliate—This term is used to describe a company formed by banking organizations to deal in securities of various types, some of which may not, under the Federal banking laws or state banking laws, be dealt with by a bank. The proposal that has been presented to Congress is that these security companies, where owned by national banks or national bank associations shall, like national banks, be subject to the supervision of the Comptroller of the Currency.

Would Extension of the Branch

PRO

by J. W. Pole

COMPREHENSIVE study of the banking situation clearly indicates that the system of banking in the rural communities has broken down through causes beyond the control of the individual banker or the local community. These causes are of a basic nature and have many ramifications throughout the great economic and social changes which have occurred in the United States since 1914. I shall not attempt a detailed analysis of this situation except to say that the economic movement away from a large number of independent local utility and industrial operating units toward a stronger and more centralized form of operation in the large cities has curtailed the opportunities of the country bank for diversity and extension of business while broadening those opportunities for the large city bank.

In the absence of legislation to remedy the conditions above described, private enterprise has within recent months undertaken to meet the economic situation presented by the growing isolation of the country banks. Local holding companies have been formed in many sections of the country for the purpose of bringing together a number of banks into a single operating group. The usual procedure is for the holding company, a State corporation, to purchase a majority of the stock of several banks, one of which would be a large city bank which in effect becomes the parent bank of the group. The management personnel of the central bank becomes in practice the responsible management for the entire group. Through such a group system it appears to be possible to make a close approach to a form of branch banking whereby each operating unit leans for support upon the central bank, or upon the holding company, and receives the benefits of its moral and financial support; its prestige and good will; its extension of the wider type of banking service; and the benefits of its highly trained management.

If branch banking were permitted to be extended from the adequately capitalized large city banks to the outlying communities within the economic zone of operations of such banks, there would be no logical reason for the existence of the local holding company and it would give way to a system of branches operated directly by the central bank of the group.

These conditions would seem to warrant a further amendment of section 5155 of the Revised Statutes of the United States as amended by the act of February 25, 1927, known as the McFadden Act, to permit national banks, with the approval of the Comptroller of the Currency, to establish branches within the trade areas of the cities in which such banks may be situated. These trade areas may in some cases be coextensive with Federal reserve district lines; in other cases they may be of a more limited extent, but in my judgment they should not extend beyond Federal reserve district boundaries, except to take care of a few exceptional cases where a trade area may extend from one Federal reserve district into another, nor should a bank be permitted to establish a branch in another city in which there is a Federal reserve bank or a branch thereof.

Under such a system of branches there would gradually be extended to the agricultural communities from the large city banks a safe and sound system of banking which would render remote the possibility of bank failures. There would, however, be no compulsions upon unit banks to enter a branch organization. The two systems of banking—unit banking and branch banking—would no doubt operate side by side for an indefinite length of time; that is to say, there would be in every rural section some unit banks well organized, competently managed, and held in high esteem by the community which would continue to operate advantageously.

In most of the discussions of branch banking the depositor seems to have been lost from view. It is said that branch banking will lead to a restriction upon local loans—that the borrowers will suffer. To this theory I do not subscribe. It is unreasonable to suppose that banks will make substantial investments in branches without any expectation of developing the business of the branch. This can not be done by draining the community of its cash. It can be done only by rendering to that community a scientifically balanced banking service including the making of loans as well as the receiving of deposits.

Certainly it would be possible for the parent bank to develop a diversified banking business to protect it against economic depression in any one locality or in any one industrial activity or business enterprise. I am, however, more concerned with the depositor, especially the savings depositor, than with the borrower, and have therefore approached the question of branch banking as a remedy from the standpoint of safety to the depositor and to the local shareholder.

There are great commercial centers in the various regions of the United States. Under our present system of banking there has already occurred a concentration of banking capital in the commercial centers and more particularly in New York City. The growth of our cities in population and in commercial importance has naturally led to the growth of larger and stronger banks. But it is not only in banking that this concentration has taken place, but rather that banking has followed the concentration of capital and centralization of management in other fields.

The modern city itself is in a much closer relationship to the outlying territory than was the case a few decades ago when communication and contact were dependent upon horse or intermittent railroad transportation. Communication by telephone is now almost universal, having largely displaced the slower methods of communication by mail and messenger.

Continued on page 310

Banking System Be Beneficial?

CON

by Henry M. Dawes

THERE are three manifestations of bank centralization in the United States. Up to a few years ago the chain was the most widespread; then in certain States branch banking developed, and recently the organization of holding companies has combined the two principles and extended them. Branch banking is concentration carried to the nth degree.

The recent development of holding company control of unit banking operations is probably the tendency that has precipitated the present unrest.

If this principle of indefinite centralization and consolidation is carried to its logical and obvious conclusion, the outcome will be that the banking system of the United States will be in the control of a few organizations. Undoubedly a great many bankers located in our large interior cities have visions of developing holding companies which control the banking situations in their sections, and the ambition eventually to become overlords of feudal principalities, coextensive with the Federal reserve districts. They can draw a most alluring picture and appeal most strongly to provincial and sectional prejudice. Personally, I have never been able to locate Wall Street very definitely, except in a geographical sense, but whatever Wall Street may be they expect in this way to become emancipated from it. If it is feasible to concentrate the banking of a Federal reserve district in one control in 12 districts, does it require any very great stretch of the imagination to conceive of a combination of these 12 districts and a new and real Wall Street? Call it by any name you will, the concentrated control of banking in a few hands is involved, and in spite of the size and resources of our country the number of hands will be very few.

There is an economic argument and a social excuse for industrial and commercial consolidations which, on account of the quantity theory of production, can better supply the needs of the public, but credit is not a commodity. No legitimate parallel can be drawn between the large industrial unit, covering a great territory, and the large banking unit with distant ramifications. Your industrialist is dealing with a commodity which he has bought and paid for; the banker is dealing with other people's money.

In those cases where the problem of the small, unsound bank can not be solved, and their elimination has been brought about, the central organization claims a great public service in offering to set up branches. The extent to which it is feasible to establish branches where units can not be profitably operated is debatable, but the communities which will support a branch and not a unit are in a small minority, and in a very large proportion of those cases there is no great public convenience and no public need taken care of. The farmer who, in the old days, had a practical radius of perhaps 12 miles with his horse and buggy, today with his automobile can cover 100 miles. If he is deprived of a crossroads bank he can go to the county seat. Conditions which, 30 years ago, justified the establishment of a branch in rural districts, have changed entirely today, and the district which can be reached from a county seat bank with convenience to its customers is, in most Eastern States at least, practically the limits of the county.

There is at the present time much discussion of the principle of the chain store, but the parallel between the chain store and branch bank is in one respect only applicable. This is in the matter of the substitution of employee for owner operation. Chain stores may or may not be an evidence of progress, but the fact that they are dealing with commodities and not with credits makes a comparison pointless. If a chain store is able to deliver its wares to its customers more satisfactorily than the local merchant, it is because of an advantage over their small competitor which the group banker does not have over the small banker. If the chain store can sell more cheaply than its competitor, it is because it can buy more cheaply because it buys in large quantities. Paying less for its raw material it is in position to sell its product at a lower price. This is the only advantage it has over the local merchant because its other operating expenses are as great or greater. The product with which a banker deals is money.

The price that he pays for money is interest, plus losses on bay loans. As far as the depositor is concerned, the small banker usually pays less interest on deposits than does the big banker. The general price of money, however, is reflected by the Federal reserve rate and Federal reserve funds are available at the same rates and on the same terms for big and little bankers. The big banker, therefore, does not get his stock in trade any cheaper than the little banker. The remaining factor in the cost of this raw material—money—is the extent of losses in bad loans. Bad loans are due to either incompetence on the part of the banker or a disposition on his part to render service to his clients and to his community even though it involves a certain recognized risk.

Let us analyze this question of incompetence. The complacent arrogance of size and wealth asserts that the big operator, whether in banking or any other commercial pursuit, is a better man than the little operator, allowing for no fortuitous circumstances by which the big man may have achieved his greatness. Assuming then that the big banker is a better man than the little banker, he is handicapped in his operation because he knows less about his credit risk than does the little banker, especially if the big banker is a chain banker and the little banker is a unit banker. The unit banker, particularly in the smaller communities, is the personal acquaintance and friend of the man who makes the loan. He is familiar not only with the details of his business, but he knows his

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It might be found feasible to permit national banks to extend branches into the trade area of the city in which they may be situated. I realize that while the term "trade area" itself is susceptible of definition, there may be found some practical difficulties in mapping out a given trade area. Theoretically, of course, every city, no matter how small, might be said to have a trade area, but it would prove no solution at all to the rural bank situation to permit small country banks to establish branches in such trade areas.

The trade area which I have in mind may be called the metropolitan trade area. Such an area would circumstance the geographical territory which embraces the flow of trade from the rural communities and small cities to a large commercial center. Branch banking extended by metropolitan national banks into such a trade area would naturally give to these outlying rural communities and smaller cities a strong metropolitan banking service.

I am not prepared to attempt to arrive at a legislative formula which would automatically delimit all of the trade areas in the United States. It does not seem possible to meet this situation with such a formula. When the Federal reserve act was before Congress a similar situation arose with respect to the Federal reserve districts. In that act Congress did not attempt to define the boundaries of the districts, but provided that the districts should be apportioned with due regard to the convenience and customary course of business and that they should not necessarily be coterminus with any State or States. The Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency acting as a committee were empowered to lay out the districts.

The 12 Federal reserve districts thus laid out and the subdistricts within them as established by the Federal Reserve Board constitute today the only areas which have been delimited upon the basis of the relationship of the flow of trade to banking services.

It may be found advisable to adopt a similar procedure with respect to the present situation if it is determined that national banks shall be permitted to have branches in the rural districts. In this connection the question will naturally arise as to how far the Federal reserve districts or subdistricts are applicable to this question of branch banking.

It has been urged as a consideration against branch banking that legislation permitting its extension to the rural districts would lead to the concentration of all of the banking capital in the United States in the New York banks and under the control of a comparatively small group of financiers.

It might be possible theoretically to conceive of this situation arising if Congress permitted the national banks to engage in nation-wide branch banking at the present time, although many students of banking and many practical bankers are of the opinion that even were nationwide branch banking permitted by law its spread would be a slow development out from the various commercial centers; that the country is too large and its financial operations on too vast a scale to permit of complete concentration in New York City. The banking resources of the United States are constantly increasing as the country develops industrially and commercially. With great commercial cities developing in various parts of the country outside of New York, it would seem an extravagant prospect to contemplate the control over these resources within a few hands in a single city.

However, the proposal which I have brought would, it seems to me, clearly tend to decentralize banking capital through a system of regional branch banking. The metropolitan banks in the city of New York have always held a pre-eminent position and under any system of banking which would follow the normal course of business they will continue to increase in size and influence. Notwithstanding this aspect of the matter, branch banking emanating from commercial centers outside of New York City into surrounding trade areas would cause the New York banks to decrease in relative importance. There would be concentration of capital, but it would be a regional concentration with local characteristics. Banks in Detroit, Cleveland, Boston, Atlanta, New Orleans, St. Louis, Buffalo, Minneapolis, and other such local commercial centers would grow into institutions fully capable of taking care of the financial requirements of their trade area communities. Instead of nearly all of the largest banks being situated in New York City there would be in every such commercial center banks whose resources would approach or exceed a billion dollars. Instead of being a menace would not such banks become a source of pride to the community in which they are situated, bringing prestige and new business to the city and taking out to the rural communities a strong and highly developed banking service with safety to the depositors there? Would not such a system of branch banking lead to an active competition for business which would naturally result in the local community obtaining cheaper and better banking service?

Some critics of our banking system take the view that we have too many small banks and that one of the chief causes for bank failures has been the issuance of an excessive number of charters by the State and Federal Governments. Theoretically, of course, if no banks were chartered there would be no bank failures. There is no way by which the number of banks can be categorically determined in advance and consequently the laws of all of the States and of the Federal Government have left the discretion to the supervising executive officials. It comes down to a plain question of human judgment. If no more bank charters were issued, for example, in communities where all of the banks had failed the Comptroller of the Currency or the State banking superintendent as the case may be, would have to take the responsibility of denying banking services to such a community even though the new applicants for a charter possess the qualifications required by law and practice to carry on a small bank. In view of this situation it can not be expected of the supervising bank officials to take it into their hands without further legislative sanction to reform the system of banking in the rural communities through the process of denying bank charters. My own point of view is that the rural communities are not supplied with adequate banking facilities. I should like to see the people of every community, no matter how small, have access to more than one strong bank with the banks competing for business. All persons should have the benefit which

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character, experience, and ability. He has every advantage over the man who must form his conclusion as the result of the recommendations of a minor employee in a distant city. The owner of a bank will make less bad loans than an employee whose superior may be a thousand miles away. If, however, banks are to be conducted as pawn shops, where standard collateral is the only basis for loans, it makes no difference whether loans are made by financiers or clerks. Anyone can apply the simple formulas.

If banking is not considered as a social responsibility, there is no excuse for any bad loans. This is not the case, and certain risk must be taken in the interests of progress and in response to the public interest. Remembering that the banker is a trustee for the community's funds, he has no more right to withhold them unreasonably than he has to disburse them carelessly. As a member and a product of the community in which he operates, the unit banker is in a position to appraise the public needs and to administer them more sympathetically and more intelligently than the absentee banker. In doing so it is not impossible that he may, at times, incur losses which the absentee banker would not, but these losses which are made in the exercise of public responsibility will not, in the main, offset the saving he effects over the operations of the chain institution because of the intimate personal acquaintance with the creditor. In considering such losses of the unit banker as may be the result of too great liberality to local enterprise, it must be remembered that the money which is lost to the bank is not lost to the community, that the brick and mortar upon which these funds may have been expended are still in the community, whereas if the funds are loaned by absentees to absentees the loss registered on the balance sheet is a loss to the community. The big bank and the little bank, therefore, start with the same base in the cost of raw material. Their additions to this in the way of losses are no widely different, and the only advantage, therefore of one over the other must be economy in mechanical operation.

Economy in mechanical operations is a thing which can reasonably be assumed for both the branch and unit system. Such advantages as there are, however, in my opinion, rest entirely with the unit system. The overhead of a central organization and the red tape which is involved in its operation, the delays in decision, the division of responsibility, and so forth, ad infinitum, are inherent in size, and are a deadweight which the injection of specialists does not offset.

The availability of money is as important as the price thereof. It is conceivable that in the city of the central bank, on account of drawing funds from the smaller communities, more money would be available, but it hardly is in accordance with nature for the central office communities to pump its funds out to the smaller branches. The inevitable results of centralization will be to restrict the activities of smaller centers, and to accelerate the concentration of population in the larger cities.

Under the unit system of recent years, the percentage of loss to depositors in large banks has been so small that it is practically negligible. The problem of safety is largely a small-bank problem. The group banker suggests that he will solve this by extending his branches or chains to the communities in which these little banks are located. How does he intend to do this? Does he intend to buy up the good banks of the community and incorporate them in his chain? If so, he hasn't improved the situation. Does he intend to buy the bad banks? I have not heard of them suggesting this. Does he intend to compete with the good banks? This would not be desirable, as it would substitute absentee control with no compensating advantages. His answer would hardly be that he would want to compete with the poor banks, as obviously that would quickly cause their failure and injure the community. It seems to me that the only claim must be, and it may be a fair and reasonable one, that his objective is to eventually supply branch or chain banks to every community that needs banking facilities, and to the complete exclusion of the unit bank. If he can operate as economically and serve the community as well as the unit bank he will soon eliminate the unit banks.

Unit banks can not survive the competition of chain or branch banks. They serve the community better, but it is at a serious disadvantage in two respects. In the one case certain clients who are very profitable to a bank are compelled to patronize the chain or branch institution in all matters because they can serve them in some. The management of a concern which operates in a number of different cities is very often associated in business enterprises with the men who are conducting central institutions, and will, as a matter of course, patronize their branches at the expense of the unit banks. When he is not associated with them either socially or in a business way he frequently has to meet them in connection with the issuance of securities. When he does this he incurs, either directly or indirectly, an obligation to patronize their branches. Whether he wants to or not, he is in a position where he feels that his interests require him to throw his business to the big chain rather than to his friend and neighbor. This class of patron usually constitutes a large portion of the cream that is now coming to the unit bank. Furthermore, entirely outside of the banking relations, the operators of small commercial and business enterprises are very much handicapped in meeting their larger competitors if those competitors have the ear and the approach to the avenues of credit that can only be reached in central cities after the unit system has been discarded. This situation can not be ignored by the assertion that the chain bank can offer facilities that the unit bank cannot, because there has never been a time in the history of this country that, through the operation of the correspondent system and the use of various methods of syndicating loans in financing, it has not been possible for the small banker to accommodate his clients who are entitled to credit. The difference is that in the one case the client is dealing with a friend and a neighbor, and in the other he is dealing with a stranger in a distant city, and as every unit bank becomes attached to a chain the opportunity for syndicating cooperative arrangements between others is narrowed. It can not, I think, be contended with justice, that when the country is eventually under the centralized system these banking arrangements can be made with more celerity, if at all. There are few business men who are not familiar with the red tape which is essential to safety in the operation of a very large organization.

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comes from a competitive banking service. Our present system of independent unit country banks cannot provide it. Would not the system of decentralized branch banking which I have suggested meet this condition?

It is recognized that a system of branch banking such as I have suggested would gradually bring about the development of greater banking institutions in the inland commercial centers and in the larger seaports of the country. These banks would be strong enough to resist the ordinary local causes of bank failures on account of the great diversity of their business. The only danger of failure would be in the management personnel and it is conceded that any bank or any sort of business institution can be wrecked through mismanagement and maladministration. There can be no absolute protection by law or otherwise against this condition. It can, however, be so greatly minimized by governmental supervision that the danger of any such failure will be remote.

Should Congress adopt such a branch banking policy there should be an expansion and an intensification of Government supervision. There would have to be a more constant contact with management policies than now obtains. The number of banks would be less and it would be easier for the Government to supervise and examine more closely and more often the operations of such larger institutions. It should be borne in mind that such a bank would have no difficulty in securing capable management and that it would, on account of the great value of good will, be sensitive to public opinion. It would not wish to encounter the just criticism of a Government official.

Congress has always recognized the necessity of maintaining adequate supervision over the national banks. The Comptroller of the Currency now has sufficient power to supervise the national banks in so far as examination into their affairs are concerned. The time and method as to examinations is left to his discretion except that he must under the law examine each bank twice a year. What other powers the Government of the United States should exercise over such larger institutions which would come into existence under the extension of branch banking I am not prepared at this time to recommend, but should the Congress desire to go further into this question the office of the Comptroller of the Currency will be at its service.

In conclusion, I feel it necessary to make some remarks with respect to a comparatively recent banking development which is coming to be known as group banking. Before proceeding further, however, I think that we should attempt to get down to definitions. In current discussions the terms "chain banking" and "group banking" are sometimes used synonymously and sometimes as opposed to one another. Frequently the phrases "chain and group banking" and "chain or group banking" are used.

The term "chain banking" has been in use for many years in this country to describe a condition in which a number of banks were owned or controlled by the same individual or by a group of individuals. These so-called chains were situated very largely in the rural districts and the member banks of the chain were principally small country banks. This condition was and still is quite prevalent in the agricultural regions of the West and South. Many of these chains have come to disaster through the failure of all of the banks which constituted them. During the many years this type of bank ownership has been in existence it was not considered as a trend toward a fundamental change in our banking system nor did it relate itself to the question of branch banking. On account of the failures of several of these chains the term "chain banking" began to carry with it an element of disfavor.

The term "group banking" is of very recent origin and is being used to describe what appears to be a major movement in our banking system. The principal factor in group banking is that each group is centered around a city or metropolitan bank through means of a holding company, which owns the majority of the stock of each bank, thereby creating a system of banks more or less integrated in management with the central bank of the group. Its one common factor with the older type of chain banking is that several country banks may be owned by a single agency. In this discussion, therefore, I shall use the term "group banking" to mean the ownership and some element of operating control of several banks through the medium of a bank holding company. The holding companies are incorporated under State law, and the Government of the United States has no immediate access to information concerning their organization.

From the character and standing of the bankers and other business men engaged in some of the principal groups in this new group-banking movement I have no doubt that they will be able to work out a system which will be profitable to the group company and give a safer and better banking service to the communities in which they own banks than was possible under the system of rural unit banking.

While perhaps my views may be immature, I am inclined to the view that group banking under its existing forms is not desirable as a permanent system of banking. Where a group is composed of both State and national banks, as well as of other types of financial institutions, it becomes practically impossible for any supervising governmental official to ascertain authoritatively and accurately the financial condition of the group as a whole. Each corporation in the group is an independent legal entity, some responsible to State governments, and some, that is, the national banks, to the National Government, while other State bank members of the Federal reserve system are responsible to both State and National Governments, and this creates a situation in which the public is not sufficiently protected, in so far as it can be protected by governmental authority. If a group were all national banks and the holding company were placed under the visitorial powers of the Comptroller of the Currency it would be possible, although difficult, to supervise the operations of the group. I may say, however, that if the Comptroller of the Currency be given visitorial powers over bank holding companies engaged in group banking, the Government would be in a position to obtain information as to their operations and would be in a better position to regulate and control them by subsequent legislation should such action be deemed expedient.

In the case of branch banking the situation is different. Under the regional plan which I have discussed there

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In spite of general claims to the contrary, these new syndicates have done little, if anything, to solve the difficulties of the unsound small bank, whose failure is being enlarged upon as an argument for the inauguration of a new economic era. They can not solve this question, and it never will be met except by the inexorable operation of natural laws. Just as truly as there is a point at which too great size destroys efficiency, there is a point below which the unit can not survive. There are hundreds of banks of less than $100,000 capital that are sound and strong and have every element of vitality inherent in them, but the measure of such banks' ability to survive is not the size of their capital but the extent of the resources which the community can put into them. Generally speaking, however, the banks with very small capital may be assumed to have very small deposits, and the overhead cost of such an operation is such as to prevent their thriving, and the principal reason for their failure is the fact that they can not afford the expense involved in securing the service of competent officers. To expect to secure a very high class of talent for a salary of $2,500 to $3,000 a year, which is all that a very small bank can pay, is unreasonable.

The responsibility for this rests primarily with Congress and the State legislatures in permitting the chartering of too small institutions, and secondarily with the authorities, both State and national, to the extent that they should have exercised discretion in refusing charters where communities did not require them. The discontinuance of the issuance of further charters below a reasonable limit would be constructive. The only thing that can be done for the unsound banks which are now in existence is for the supervising authorities, State and national, to help them to bring about liquidation in a way that will occasion the least loss and to supervise the sound banks as carefully as possible and stop chartering too small institutions for which there is no need. The injection of the branch and the chain system will only exaggerate a bad condition.

The Federal reserve has been in successful operation for a matter of some twelve years and it is natural to fall into the habit of thinking of it as though it were an independent unit rather than as it actually is, a coordinating agent. It is merely the composite of the members of the system and automatically changes with any change of its constituents. To recall this obvious fact centers attention on the effect of changes which private banking innovations will have on the Federal reserve system. The operations of State and national banks and the Treasury Department and the Federal reserve are inextricably interwoven and it is impossible to legislate in any matter affecting one independently of the other. The Federal reserve was organized because of the ability of the Federal Government to enforce the more or less unwilling and certainly unenthusiastic cooperation of the national banks. This was later followed by the timid and tentative approach of the State banks, so that its membership at the present time is partly compulsory and partly voluntary. It is the final evolution of a century of finance and the solution of the conflict of the years between the centralization theory and the independent unit theory. In a sentence, it consists in the application of coordination to independent units.

With the development of chain, branch, and syndicate banks the membership is being changed from that of independent, locally operated units to centralized groups under absentee control. Every group which is organized along these lines decreases the number of persons who, in its last analysis, would control the operations of the system. In the case of holding companies, the holding companies themselves are under the jurisdiction of State officials. The State banks are under the supervision of 48 different superintendents, and the national banks are the only private institutions engaged in banking over which the Government has direct control.

This brief statement of fact makes clear that with the decline of the national banks, the direct influence of the Government on banking operations is decreased, and the further fact that with the organization of groups, the democracy which has characterized the operation of the Federal reserve system is being undermined. It seems to me desirable, therefore, that the Government should do every possible thing that it can, in justice to the State banks and the Federal reserve, to strengthen and develop the national banks, through which it financed the Civil War and organized the Federal reserve system. The other matter of the centralization of the control of independent units involves a control of the Federal reserve system. When in the logical development of this tendency, the control of banking in the United States gets into a very few hands, control of the Federal reserve system will go with it into the same hands. In discussing chain, group, and syndicate banking you are, therefore, discussing the whole fiscal system of the country, both private and governmental.

It seems to me that there is no room for compromise on this subject and that a determination should be reached as to whether the United States wishes to embrace a national system of branch banks or to preserve its coordinated independent units. It can not do both.

When the greatest exponent of branch banking, both in practice and in theory, states that in his opinion the development of chain and syndicate banking is a step toward national and international branch banking, it bears the weight of logic, as well as of his prestige. Rather than to temporize and to attempt to compromise a fundamental issue, the interests of the public would in my opinion be better served by determination as to whether or not branch banking is desirable. Compromise and permissive legislation would have the effect of strengthening the movement to such an extent that when ,at some later time, the public rebelled against monopolistic tendencies, it would bring about a convulsion which would hurt everyone.—*Extracts, see 4, p. 302.*

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by Elmer E. Adams

THOSE bankers who still control their own banks and hope to be able to do so are opposed to the establishment of branch banks outside of the metropolitan districts. Group banks have probably become established to such an extent that it is impossible to undo what has been done. However, the individual banks which are on their feet have no fear of being unable to com-

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would be no need of an operating holding company. The parent bank would be the only corporation in operation and it would have offices in various places within the trade area. There would be only one board of directors and one set of corporate minutes. The formulation and initiation of the policy for the bank would be subject to a single responsibility and the Comptroller of the Currency (or the State superintendent in case of a State branch system) could at any time determine the true financial condition of the bank with all its branches.—*Extracts, see 4, p. 320.*

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by Robert V. Fleming

OUR bank (the Riggs National) has in operation six branches within the District of Columbia, all these branches being what are known as statutory branches, that is to say, branches which have been established under specific statutory authority under the national banking laws.

Although our bank is engaged in what may be called city branch banking, as contrasted with the extension of branches into outlying cities, it has nevertheless maintained the local contact which existed in the bank taken over at the time it became a branch. The one exception is that of a bank, the management of which had lost the local confidence necessary to maintain it. This local contact we regard as of the greatest importance to the success of branch banking, and good business practice alone is a sufficient reason to preserve it.

Our bank has an advisory board of the branches, and upon this board are the principal members of the boards of directors of the banks which were converted into branches, all of those serving being shareholders of the bank. In the case of the Farmers & Mechanics branches, the entire board of directors of the bank became members of the advisory board. This board has 33 members, five of whom are officers of the central bank and it meets once each quarter at the main office of the bank, at which time all of the operations of the bank, which includes the operations of each branch, are carefully reviewed. Respective executive committees of the advisory board meet weekly at the branches, and, in addition, that part of the advisory board constituting the former directors of the Farmers & Mechanics National Bank meets monthly at that branch. The advisory board performs the same functions with respect to the branches that it performed with respect to the pre-existing banks, except that it recommends policies and procedure, instead of initiating them.

It has been our policy to carefully select our branch managers, and to give them rather wide discretion in the operation of the branch. Only matters of importance are referred to the main office, minor matters being handled by two liaison officers from the main office, who are in daily contact with each branch. In the making of loans, branch managers are authorized to make loans up to $25,000 to a single customer upon listed collateral, and in some cases up to $5,000 on an unsecured note. This latter authority varies from $1,000 to $5,000 according to the branch and the needs of the community which it serves. In connection with applications for loans beyond these amounts, the branch manager appears before the loan committee at the main office and presents the case to that committee for determination. Each branch manager is required to maintain his own credit files and is charged with the responsibility of following the loans made at his branch. We have found that the discretion and authority granted have been sufficient to take care of the ordinary operations at our branches which are, in the main, showing steady increases in deposits and in the number of customers served.

The District of Columbia is the smallest political unit in the country by virtue of the lines which were established when the Federal Government was first set up. As the seat of the Capital of the Nation, a large metropolitan city has grown up within it and has overflowed into the surrounding area of Maryland and Virginia. Under similar circumstances in the various States, cities of corresponding and lesser size have from time to time enlarged their political limits to embrace suburban districts. This cannot be done by the city of Washington. As a consequence, we seem destined to have a great business center in the city of Washington, supported by many residents in nearby suburbs outside of the District.

This all might be called the metropolitan area of the city of Washington, or Greater Washington, and its banking business would normally flow into Washington. Looking at the situation from the standpoint of our bank and other banks similarly situated in the District of Columbia, under any amendment extending the power of national banks to have branches beyond the city in which they may be situated, it would be a natural and easy progressive development to extend branches from banks in the District of Columbia into these suburban communities.

For example, in Maryland there are 10 and in Virginia there are 9, a total of 19 places around the District of Columbia doing their principal business in Washington, and which could be served with branches of Washington banks with the same facility of operation as those branches now situated in the District of Columbia. This extension I would not call trade area branch banking, but rather the same type of branch banking which exists in a number of metropolitan cities like New Orleans, Atlanta, Cleveland, Detroit, Cincinnati, Los Angeles, and so on, where national banks now have branches.

Coming now to the larger question that of a wider extension of branches into the rural districts, it is my opinion that a sound system of branch banking could operate from Washington within an area of some 50 miles. It must be recognized, however, that in each of these towns there would be some overlapping of trade areas between Washington and Baltimore, on the one hand, and between Washington and Richmond on the other, because the business of those places is somewhat divided between the cities mentioned.—*Extracts, see 4, p. 320.*

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Adams *Cont'd*

pete successfully with group banks unless unfavorable legislation is passed.

We do not want to have new group banks established in communities which are already amply supplied with banking facilities, but we are not opposed to group banks acquiring banks now established. We do not like to see the propaganda put out which has been put out so generally, that the individual or unit banking system has broken down and has failed to meet the responsibilities and obligations which the public could expect from it.

Many statements have been made which are detrimental to the unit banking system which are partially or wholly untrue and which leave an erroneous impression among the public and patrons of banks. A difficult situation has been made worse for a good many banks which were not in proper condition by advertising the vast resources which the group banks make available to the communities which they were anxious to serve. The unthinking depositor does not realize when he reads of the tremendous resources that the liabilities increase correspondingly and that the smaller bank is just as safe as a larger one if the same ratio of capital, assets, and liabilities is maintained and it has the same efficiency of management.

The unfortunate situation which has developed in the Northwest and in some other parts of the country is not in our opinion due to the failure of the present system of banking, but because Congress and legislatures have permitted the establishment of banks with too small capital and in communities which were unable to support them. We feel that a serious error was committed when the National Government reduced the necessary capital from fifty to twenty-five thousand dollars for a national bank. Until recently State banks have been permitted with a capital of $10,000 which has hardlly been enough to provide a building, a safe, and an adequate sign.

There is not the slightest doubt that if banks had not been permitted in locations where it was impossible for them to succeed and had not been undercapitalized many failures would have been averted. It has been claimed that a large number of villages which have enjoyed banking facilities are now without them and that it is desirable to have branches established in such places. We do not believe that such is the case and under present conditions of travel farmers and business men who were accustomed only a few years ago to drive with their teams to trade or to a bank, now cover a distance of 50 miles as easily as they did 10 or 12 under former conditions. I venture the opinion that these branch offices would never justify the expense. People like to come to the larger towns where the roads are good.

The chain or group bank idea is not new, although it has had a fresh start on a larger scale in the last year or two, with a slightly modified plan. These chain systems have almost always been controlled and operated from the large cities. Sometimes an interest in a local bank was acquired, but in most cases new banks were established as new towns sprang up with the building of railroads. Some of these chains have been quite successful, but many met with disaster. The plan of operation from the large city included the selling of farm mortgages which the frontier bank was expected to obtain and send in to headquarters. The commissions were so good that there was intense rivalry in securing these loans, and they constantly grew larger, faster than the land increased in value. These loans were disposed of through the head office, and so long as values went up and the farmers were able to pay, business was good; but instead of using the profits to build up a surplus and undivided profits to put the bank in a position to take care of the set backs which were sure to come and which have come, the profits were drawn out by the controlling head, used to establish other banks, or diverted into other channels, with the inevitable result that there was nothing on hand to take care of losses when they came.

It is a matter of regret that in the Northwest, when a bank has failed, a post-mortem could not have been held, so that the public, or at least the bankers, might know what had brought about the disaster; but when a bank fails, the depositors take what they can get. They never learn what became of their money.

Some of those who have lived here in the Northwest have known all these years what chain systems have been doing to the country districts and the country villages. The first chains to be established were the country elevators. As a result of these chain elevators the profits from handling the grain, which was the great business of the country, did not remain in the local communities, but went to the terminal cities just as the profits of the chain banks will go there in the future.

The chain elevators were followed by the chain lumber yards and in the saloon days by chain saloons operated from the big brewery by an irresponsible bartender who was moved whenever he got into trouble and another equally good man put in his place. There are four banks in the city in which I live: Two national and two State. One is owned by one of the newly formed bank groups. Nine hundred and two shares of the stock of that bank are owned in the Twin Cities and the balance of the capital stock is either owned here or is perhaps lent to qualify directors. The stock of the other banks is owned in the community and if there are any profits, they are kept at home for home purposes. There is no doubt which system is the most desirable for the local community.

We stand an equal show with the chain banks in getting local business. The chain banks have a better chance to get business which is controlled elsewhere. There are something like 20 chain institutions in our city. The banking business of these chain stores and institutions is controlled from the headquarters' office and the chain banks through their head office have a better opportunity to get it. It is not considered very valuable, however, as the funds are transferred almost as soon as they are deposited. We are confident that banks locally owned can be operated at much less expense than those which are owned elsewhere and have to carry the overhead charge of the parent company. I have always maintained that the stock of a bank should be owned locally by the substantial men of the community whose money was in it and whose wealth was behind it.—*Extracts, see 4, p. 320.*

Should Credit Eligibility Provisions

PRO

by U. S. Senator Vandenberg

THE country needs little else than confidence to put it under brighter skies. The external credit agencies proposed by the President are fine. But basic credit liberalization of reasonable nature should take root in our basic Federal credit agency; namely, the Federal Reserve itself. Such legislation was the first general entry on the President's emergency program formulated in his White House Conference last month. In some useful form it should be the first nonpartisan job of the new Congress.

Banking authorities in a mojority of States approve the liberalizing amendments to the Federal Reserve Act which Governor Young of the Boston Federal Reserve Bank and I will submit to the Senate Banking Committee. The results of a poll I have taken in cooperation with Bank Commissioner Reichert of Michigan on the following proposals submitted to the bank commissioners of the States are given below:

(1) To admit to rediscount certain bonds and warrants of States, counties, cities and other tax districts: (2) to create under proper safeguards a temporary emergency rediscount privilege covering any sound assets in a solvent bank. The States voted as follows:

Yes: Alabama, Arizona, Florida, Georgia, Illinois, Indiana, Iowa, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, Nevaka, New Mexico, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, Wisconsin, Wyoming—25.

Yes (with reservations): Connecticut, Delaware, Kansas, New York, Rhode Island, Virginia—6.

Part Yes and Part No: New Hampshire, North Dakota, Idaho, Montana—4.

No: New Jersey, California, Minnesota—3.

The other 10 States either were noncommittal or did not reply.

This poll unassailably reflects the opinion of the country that the credit base of the Federal Reserve System should be conservatively broadened. The National Credit Corporation has served to stop the stampede of needless fear which has done incalculable damage to the country. If we now carry the same credit philosophy into the Federal Reserve itself it ought to stabilize confidence.—*Extracts, see 9, p. 320.*

□

by The Nat'l Ass'n of Finance Co's.

THE Federal Reserve Act or the Regulations of the Federal Reserve Board should be amended so as to make eligible for rediscount the notes of banks and of financing or credit companies, the proceeds of which are to be used for financing the sale of merchandise in either wholesale or retail transactions.

The amount of paper eligible under existing regulations for rediscount at the Federal Reserve banks has, for several years, been steadily decreasing, due to changes in methods of financing business transactions, with the result that bankers are becoming uneasy over the small amount of eligible paper in their portfolios.

There is danger that the further continuance of this process may result in a condition where there will not be in existence enough eligible paper to support the expansion of currency needed in a crisis.

The notes of finnancing companies, the proceeds of which are to be used to finance sales of merchandise, have all the essential qualities prescribed for eligible paper in the Federal Reserve Act, namely, "Notes, drafts and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used or are to be used for such purposes," and are also as safe and sound as any other class of commercial paper.

The inclusion of this class of paper would add between one and two billions of dollars to the average existing amount of eligible paper, which addition would go a long way toward making up the present apparent deficit, although not completely doing so.

A characteristic type of transaction referred to is that involving deferred payments, where retail merchants sell goods to the ultimate consumers on a partial payment plan, taking as security for the deferred payments chattel mortgages, conditional sales contracts, bailment leases or similar lien documents entitling the seller or his assignee to recover the goods in case of default in payments. These documents are then purchased by the banks or by finance or credit companies, which issue their own notes to obtain the necessary credit.

The financing concerns referred to are frequently banks, but are perhaps more often companies organized especially to perform these functions, and are generally known as "finance companies." The finance companies usually obtain part of the funds necessary for conducting their business from banks. This is sometimes done by way of a line of credit, without other security than the general responsibility of the borrower, but more frequently by means of promissory notes usually secured by the deposit of installment contracts or other lien documents arising out of transactions above described.

Notes whose proceeds are to be used for financing the transactions described above come within the definition of eligible paper of the Federal Reserve Act (Sect. 13), namely "Notes, drafts or bills of exchange arising out of actual commercial transactions; that is, notes, drafts or bills of exchange issued or drawn for agricultural, in-

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# of Federal Reserve Act be Broadened?

CON

by U. S. Senator Glass

THE proposals of President Hoover for setting up certain temporary corporations and attempting certain temporary expedients are being eagerly seized on by various interests to particularly broaden the field of bond and stock speculation, primarily responsible for the existing depression. In a word, it seems to me that another attempt is to be made to clutter up the Federal Reserve banks of the country with speculative securities and thus amplify the opportunities of stock and bond operators to ply their trade to disturb the business of the country periodically as a result of their excesses.

Before there is any broadening of the base of "eligible paper" for borrowing at the 12 Federal Reserve banks there should be a very careful and searching inquiry as to the necessity of any such movement with a view to ascertaining whether there has been any denial by these regional banks of adequate credits to legitimate commerce, whether mercantile, industrial or agricultural.

No single convincing fact has been adduced from which it may be inferred that there has been one particle of curtailment of credit at the Federal Reserve banks to these various legitimate interests. On the contrary, the startling fact has been disclosed that on June 30th last the member banks of the Federal Reserve System had in their portfolios $3,198,000,000 of commercial, industrial and agricultural paper eligible for rediscount at the Federal Reserve banks, exclusive of $4,000,000,000 of United States securities, made acceptable by law as a basis for rediscounting purposes. At the same time the total borrowings by member banks from the Federal Reserve banks aggregated the comparatively inconsequential sum of $147,000,000.

Thus there was and now is a margin of $3,051,000,000 between the sum that member banks might borrow on commercial paper alone from Federal Reserve banks and the sum which they actually are borrowing; and the Federal Reserve banks have facilities for loaning even more than this amount.

This conclusively proves that the greater part of the persistent talk for "broadening the base for eligible paper" is not intended to help legitimate commerce, which has not been denied ample accommodations by the Federal Reserve banks. It seems rather to be a calculated effort to expand and to stimulate speculative transactions in unliquid or frozen securities. Doing this, as any well-informed person should know, would endanger rather than strengthen the Federal Reserve System of the country.

Those interests which are now loudly proclaiming that the Federal Reserve System is "obsolete," simply want to modernize it by making it a medium for the very kind of unproductive and dangerous transactions that are largely responsible for the distress and disasters which now afflict the business of the country.

Of course Congress should promptly, without a moment of unnecessary delay, cooperate in any sane and effective plan to relieve the existing depression and particularly to guard against a repetition of the disaster; but it does not necessarily follow that this may be done by tampering with the Federal Reserve banking system in order to promote the business of those largely responsible for precipitating situations of this kind. Relief and safeguards may be effected in an infinitely less objectionable and more reasonable way without drawing legitimate business of all kinds into the mire of depression.—*Extracts, see 11, p. 302.*

□

by U. S. Senator Bulkley

I AM opposed to any relaxation whatever in the principle involved in what is rediscountable at Federal reserve banks. I can not, of course, deny that a certain measure of relaxation would give great temporary relief, and, if we could be sure that it would not go too far or last too long, it would do no harm whatever.

But the difficulty is that in the nature of the case there can be no guarantee as to how far it will go, or how long it will last, if we once set the precedent of tampering with the principles on which the Federal Reserve Act is based. I do not think it is necesesary to weigh against this consideration the extremity of the present emergency because I think it possible to meet the emergency in another way.

It seems clear to me that the announcement made at the White House recently has had some favorable effect in restoring confidence. And yet I believe that in some respects it is inadequate, and, if the suggested broadening of the base for eligible paper is to be interpreted as proposing a change in the principles of the Federal Reserve Act, it is unsound.

We are, however, confronted by a very serious condition and I think we would do well if we can find some manner of giving constructive help that is at least within the letter of the President's announced program and not inconsistent with the legitimate purposes behind that program.

There is considerable faltering about the organization of the National Credit Corporation, and even if we assume that the difficulties involved in it may be overcome with reasonable promptness so that it may actually start to function, still it provides nothing but a certain measure of relief for embarrassed institutions at the cost of a direct weakening of the position of all banks now properly fortified with liquid resources.

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Finance Co's *Cont'd*

dustrial or commercial purposes, or the proceeds of which have been used or are to be used, for such purposes." Their proceeds are to be used for commercial purposes, namely, to quote the language of the Federal Reserve Board's regulations (Sec. II-a), "in producing purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture or distribution." In fact, there is no doubt whatever, in the minds of competent judges, that if it were not for the services of financing companies in facilitating deferred payment transactions, there would not have been, and would not now be, nearly so great quantities of many kinds of goods, of which automobiles are typical, produced or distributed, as have actually been and are being made and marketed.

Thus the proceeds of the notes in question are not merely in fact used for certain very important industrial or commercial purposes, but are actually indispensable to their continued operation at normal volume.

Very large and important industries are in a great measure dependent on the easy availability of a large volume of consumer credit. If anything should cut off finance companies from access to bank credit there would follow a sharp restriction in consumer credit, and a serious curtailment in the operation of these industries, with disastrous results to the whole economic structure. Conversely, freer access for finance companies to bank credit would make for easier consumer credit, and would increase the buying rate for a number of classes of commodities, thus increasing the total volume of manufacture and commerce. This is a development much needed in the present condition of business.

The present bar to eligibility of finance company notes is in the underlined words of paragraphs (a) and (b) of Section II of the regulations of the Board as given below:

(a) It must be a negotiable note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States, and the name of a party to such transaction must appear upon it as maker, drawer, accepter or endorser.

(b) It must not be a note, draft, or bill of exchange the proceeds of which have been or are to be advanced or loaned to some other borrower, except as to paper described below under Section VI (b) and VIII.

The last clause of Section II (b) states that there is an exception to the rule there set forth, in the case of paper described under Sections VI (b) and VIII. These sections relate to paper of agricultural marketing associations and factors' paper, issued for the purpose of making advances to producers of agricultural products. Thus, in the case of agricultural paper, it is not considered necessary to hold to the rule that notes can not be eligible if their proceeds are to be advanced or loaned to some other borrower. It is contended that it should also be abrogated in the case of paper which is the subject of this petition.

In fact, there is a close parallel between agricultural factors' paper and finance companies' paper which is the subject of this petition. Both finance companies and factors serve as substantial and responsible points of concentration of large numbers of small notes made by relatively unknown makers of undetermined responsibility. In both cases, the objection to the underlying notes, from the viewpoint of the Reserve Banks, is their small individual amounts coupled with the impracticability of a central bank checking the credit of the makers. In both cases these underlying notes, is offered in any quantity to a Reserve bank, would be unacceptable, even though they complied with all the requirements of eligibility. On the other hand, notes made by the factors in the one case, or by financing concerns in the other, representing the summation of the small underlying notes, are relatively large notes of responsible makers, and in general entirely acceptable. Thus both the factors and the financing concerns are necessary intermediaries in supplying credit needed for essential "agricultural, industrial or commercial purposes." The paper of the latter is as much entitled to eligibility as that of the former.

Such paper is one of the safest kinds of commercial paper, perhaps the safest, in which a bank can invest. Finance companies rarely fail so as to exhaust their own capital. Consequently, loss to creditors is practically unknown. They have substantially no fixed assets. They have no inventory and practically nothing invested in plant. They have no large loans which may become uncollectable. Substantially their entire assets are invested in current, self-liquidating receivables. Installment notes, which constitute the bulk of finance company assets, usually run for twelve months or less, but that does not mean that if such a company stopped doing business it would take a year to collect any substantial part of its receivables.

Contrast this with the lack of liquidity of the obligations underlying agricultural factors' paper, which is now eligible for rediscount. The latter consists of farmers' notes, payable at some date usually several months in the future, after the harvesting of an expected crop. The security for these notes is the value of a crop not yet grown, subject to the vicissitudes of weather, and he boll weevil and to the uncertainties of a future market affected not only by gluts and shortages at home, but also by similar developments in India and Egypt and by the vagaries of fashion and the outbreak of foreign wars.

If finance company paper were made eligible at this time, that would immediately enable finance companies to obtain needed funds more freely and at lower rates. As a consequence, they would actively bid for business on terms more advantageous to installment buyers, with the result that the buying of many important classes of goods would be stimulated, and an important contribution would have been made to the return of prosperity.—*Extracts,* *see 10, p 320.*

□

Bulkley *Cont'd*

And although some higher figures have been hopefully suggested, it is quite likely that the amount of subscriptions to this organization will not very much exceed the originally suggested amount of $500,000,000. It is difficult to say how much will be necessary to accomplish the purposes in view, but the best opinions that I have been able to get indicate that $500,000,000 will prove far short of being adequate.

Probably nothing better can be done without new legislation, and there seems to be no chance of an extra session. Therefore, I think it important that, if possible, we should have a well-considered emergency measure ready for enactment as soon as possible after the commencement of the regular session.

The position of the entire membership of the Federal Reserve System is such that every legitimate demand for credit can very easily be met. I am advised that the officers of Federal reserve banks do not regard as strictly reliable the amounts of paper eligible for rediscount as reported by member banks. They believe that if all paper so reported were carefully scrutinized, the amount actually eligible would be considerably less than reported.

They advise, too, that the amount of eligible paper as of September 29 call is likely to be less than on June 30, and the borrowings from Federal reserve banks greater. But even after these allowances are made, there is an immense volume of eligible paper not rediscounted. There is certainly enough to justify your opposition to any tampering with the Federal Reserve System.

Notwithstanding the strong position shown by the consolidated statement of the entire membership of the Federal Reserve System, there are many individual banks, some of them important ones, which are so loaded up with loans not eligible for rediscount that they are not in position to meet demands from depositors, which, though possibly unreasonable, are to be expected in these times.

And as long as there is as much general distrust and misgiving concerning banks as now exists, it operates as a deterrent even in the strongest institutions, and becomes a very real psychological influence retarding business enterprise, if not actually threatening worse conditions of panic than we have yet seen.

It is clear that the difficulty has been brought about by lack of discrimination between quick and slow loans. No doubt it will be desirable to make strenuous efforts to prevent a recurrence of this embarrassment in the future. In the meantime, something must be done to cope with the present emergency as it exists.

If we assume that the proposed National Credit Corporation will not be adequate to the emergency and that the base for eligible paper at the Federal reserve banks cannot be substantially broadened without too great a sacrifice of principle, then if we wish to follow the general lines of the President's recommendation, we must turn to consider what can be accomplished through the instrumentality of a reincarnation of the War Finance Corporation, or through the Federal Land Bank.

I believe the emergency can be successfully met through either of these instrumentalities, but a new Central Finance Corporation will be cumbersome to get into operation and cumbersome to operate if the whole country has to look to a single newly established head office. Therefore, though I see no strong objection in principle to the formation of such a corporation, I would be inclined to by-pass this suggestion in favor of operating through the Federal land banks which are going concerns.

I am heartily in accord with the President's suggestion that the Treasury should subscribe to additional capital stock of the 12 land banks. I believe this form of relieving the land bank situation is the most practical and effective that could be suggested, and is at the same time justified by precedent.

The fact that there is ground for the belief that for considerable periods land banks did not have such adequate supervision as was contemplated by the law, the fact that not only investors relying upon the Government's watchful care of these banks but the Government's own trust fund investments for veterans and for postal savings, are very heavy losers at the present market prices of land bank bonds, and the fact that the entire program of governmental financial aid to agriculture is absolutely choked until the land bank shall be rehabilitated, all argue conclusively the absolute necessity for a further Government investment in Federal land bank stock.

Inasmuch as the investment in Federal Land Bank stocks must be made, it might as well be done on an entirely adequate scale, and it might as well be used to accomplish the relief which now seems necessary for banking institutions overloaded with slow assets. To amend the Farm Loan Act so as to permit the Federal land banks to purchase or rediscount loans made on real estate security, either agricultural or urban, or even permit them to purchase or rediscount loans based on bonds or stocks, is no serious departure from principle in the character of their holdings.

Whether we wish to make these broadened powers available only for the present emergency, or whether it would be better to make them wholly or partially permanent, may well be matter for further thought and discussion. At present I am submitting the proposal for the sole purpose of meeting a present emergency, in a manner that is sure to be strong enough to accomplish the purpose, and in a manner that involves not the slightest tampering with Federal Reserve principles.

It should be added, of course, that I expect that this proposal would involve a very large investment by the Government in Federal Land Bank stock. I have not at present any adequate data to justify a fair estimate of the amount, but if it should prove to be $2,000,000,000, or even more, I see no reason for hesitating.

In the present condition of the Treasury, it would, of course, involve further bond issues, and the present market indicates that a higher rate of interest would have to be paid than on the last bonds issued. If there are objections to more bonds and to higher interest rates on Government bonds, it may at least be said that such issues offer a greater chance than anything else to draw currency out of hoarding, and that the proceeds would be certain to be invested at a profit to the Treasury, because no bank which might be accommodated by being relieved of its slow assets would have legitimate cause to complain of being charged substantially for this accommodation.—*Extracts, see 12, p. 302.*

This Month's Contributors

E. A. Goldenweiser, Director, Division of Research and Statistics of the Federal Reserve Board.

John W. Pole, United States Comptroller of the Currency.

Charles Wallace Collins, a practicing attorney in Washington, formerly U. S. Deputy Comptroller of the Currency; author of several standard works on banking, the most recent of which is "Rural Banking Reform," published by Macmillan Co., September, 1931.

George R. Cooksey, Member of the U. S. Farm Loan Board and chairman of the Liquidating Committee appointed by the Secretary of the Treasury to wind up the affairs of the War Finance Corporation.

Representative Louis T. McFadden, Republican of Pennsylvania; beginning his nineteenth year of consecutive service in House; chairman of the House Committee on Banking and Currency since 1921.

U. S. Senator Carter Glass, Democrat, of Virginia; served in House of Representatives from Virginia for eighteen years until 1918, when he was appointed Secretary of the Treasury by President Wilson; appointed to the U. S. Senate in February, 1920, and elected in November, 1920; member of the Senate Committee on Banking and Currency and chairman of the subcommittee of that Committee appointed to investigate the banking situation.

U. S. Senator Robert J. Bulkley, Democrat of Ohio, served two terms in House; was elected to the Senate in 1930; member of the Senate Committee on Banking and Currency.

U. S. Senator Arthur H. Vandenberg, Republican of Michigan; editor and publisher of the Grand Rapids *Herald;* was appointed to the Senate in March, 1928, and elected in March, 1929.

Henry M. Dawes, of Evanston, Ill., banker and financier; formerly Comptroller of the Currency and member of the Federal Reserve Board.

Robert V. Fleming, President, Riggs National Bank of Washington, D. C.

Elmer S. Adams, President, First National Bank of Fergus Falls, Minnesota.

This Month's Sources

1—Reprinted from the CONGRESSIONAL DIGEST of March, 1926.

2—*The Arkansas Banker,* February, 1931.

3—Reprinted from the CONGRESSIONAL DIGEST of March, 1926, at which time Mr. McIntosh was Comptroller of the Currency.

4—Hearings, House Committee on Banking and Currency, February-June, 1930.

5—Federal Land Banks Circular No. 17.

6—Federal Intermediate Credit Banks Circular No. 2.

7—Pamphlets issued by the U. S. Postoffice Department.

8—From "Rural Banking Reform" by Charles Wallace Collins, published by Macmillan Co., New York City.

9—Press Statement, November 19, 1931.

10—Brief filed with the Federal Reserve Board by Nathan B. Williams, Attorney, Washington, D. C., on behalf of the National Association of Finance Companies.

11—Letter from Senator Glass to members of the Senate Committee on Banking and Currency, published in *U. S. Daily* of October 12, 1931.

12—Letter written to Senator Glass, published in *U. S. Daily,* October 27, 1931.